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In The

Supreme Court of The United States

October Term, 1971

No.

IN THE MATTER OF
THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD
COMPANY, DEBTOR

Richard Joyce Smith, Trustee of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,

PETITIONER

v.

George P. Baker, Richard C. Bond, Jervis Langdon, Jr. and Willard Wirtz, Trustees of the Property of Penn Central Transportation Company, Debtor; Manufacturers Hanover Trust Company, as Mortgage Trustee; and Penn Central Transportation Company;

RESPONDENTS

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Dated: April 28, 1972

Bowne of Boston, Inc.

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OPINIONS BELOW

The United States Court of Appeals for the Second Circuit (the "Court of Appeals")[1] rendered its decision

[1] Other frequently used contracted forms of reference herein are:

The New York, New Haven and Hartford Railroad Company, Debtor, is referred to as "New Haven."

The Penn Central Transportation Company, Debtor, is referred to as "Penn Central."

The United States District Court for the District of Connecticut is referred to as "New Haven Reorganization Court."

The United States District Court for the Eastern District of Pennsylvania is referred to as "Penn Central Reorganization Court."

The Interstate Commerce Commission is referred to as "Commission."

March 17, 1972. The decision has not yet been reported. It appears at pages A-5 – A-24 of the Appendix filed herewith.

The Court of Appeals' decision reversed the decision of the New Haven Reorganization Court. *In the Matter of The New York, New Haven and Hartford Railroad Co.*, 330 F. Supp. 131, 331 F. Supp. 212 (D. Conn. 1971). The decision of the New Haven Reorganization Court is reprinted at pages A-25 – A-60 and the order at pages A-61 – A-65 of the Appendix.[2]

JURISDICTION

The Court of Appeals' decision is dated March 17, 1972. No mandate has been entered because, on April 6, 1972, the Court of Appeals granted the petitioner herein a 30-day stay of its mandate to permit filing of this Petition for Certiorari prior to the issuance of its mandate.

The jurisdiction of this Court is invoked under 28 U.S.C 1254 (1), 28 U.S.C 2101 (c) and Rule 19 of the Rules of this Court.

STATUTES INVOLVED

The following United States statutes are involved in this case and are printed in the Appendix at pages A-1 – A-4:

Section 77(a) of the Bankruptcy Act, 11 U.S.C 205(a).

Section 77(c)(6) of the Bankruptcy Act, 11 U.S.C 205(c)(6).

QUESTIONS PRESENTED

1. Where this Court directed the New Haven Reorganization Court to carry out its opinion and judgment in the *New Haven Inclusion Cases*, 399 U.S. 392 (1970), and

[2] The Penn Central Reorganization Court entered a decision and order, dated December 31, 1971 in related proceedings. *In the Matter of Penn Central Transportation Company, Debtor*, 337 F. Supp. 779 (E.D.Pa. 1972). The petitioner herein, and others, filed appeals therefrom to the United States Court of Appeals for the Third Circuit, where the time for filing appellants' briefs has been extended.

the opinion and judgment were entered *after*, and specifically referred to, the institution of Penn Central's reorganization proceedings under Section 77 of the Bankruptcy Act, and where the New Haven Reorganization Court had reserved jurisdiction in 1968 to adjudicate matters relating to the terms of the inclusion in Penn Central of the properties and rights required to be conveyed on December 31, 1968 by New Haven to Penn Central pursuant to orders of the Commission and the New Haven Reorganization Court,

(a) was the Court of Appeals correct in construing this Court's remand to the New Haven Reorganization Court in the *New Haven Inclusion Cases, supra*?

(b) was the Court of Appeals correct in holding that the order of the New Haven Reorganization Court conflicted with the "exclusive jurisdiction" of the Penn Central Reorganization Court and "could . . . seriously impair the formulation of a workable plan for the financial resuscitation of Penn Central by the Commission and the ability of the Pennsylvania Reorganization Court to administer the entire Penn Central system," when its only possible effect on the Penn Central reorganization will be to limit what this Court had already held constitutionally impermissible, namely the further erosion of the New Haven creditors' security?

(c) was the Court of Appeals correct in holding, under its reading of *Warren v. Palmer*, 310 U.S. 132 (1940), that the New Haven Reorganization Court had no jurisdiction pursuant to this Court's remand or its own prior reservation of jurisdiction to enter orders to protect the constitutional rights of the New Haven's creditors, where the Commission lacked jurisdiction to provide such protection, which this Court had previously adjudicated?

(d) was the Court of Appeals correct in holding, under its reading of *Warren v. Palmer, supra*, that the New Haven Reorganization Court had, in essence, been ousted from all jurisdiction over the New Haven reorganization and could neither adjudicate threshold legal issues for the guidance of the Commission in formulating a new plan of reorganization for the New Haven, nor even review the terms of such New Haven plan, when so formulated under Section 77 of the Bankruptcy Act?

2. Where this Court had disaffirmed in its opinion and judgment only that portion of the New Haven Reorganization Court's order which had established an "underwriting plan" to secure the payment to New Haven from Penn Central for the properties and rights required to be conveyed on December 31, 1968, and such disaffirmance was specifically on the sole ground that the Penn Central bankruptcy had rendered the underwriting unworkable as a security measure,

(a) did the New Haven Reorganization Court have jurisdiction under this Court's remand to declare different security measures found necessary to protect the New Haven's constitutional right to receive payment for the properties and rights so conveyed?

(b) if it had such jurisdiction, was the New Haven Reorganization Court correct in adjudging that an equitable lien and constructive trust arose, as of the date of conveyance, on (and limited to) the properties and rights required to be conveyed by New Haven to Penn Central?

STATEMENT OF THE CASE

The New Haven has been in reorganization under Section 77 of the Bankruptcy Act since July 7, 1961 in the New Haven Reorganization Court. Circuit Judge Robert P. Anderson, sitting first as Chief Judge of the District Court for the District of Connecticut and then, after his appointment to the Court of Appeals, by designation, has exercised jurisdiction over the New Haven reorganization since its inception. Three trustees were appointed initially; Richard Joyce Smith is the sole remaining trustee.

The Commission, by Report and Order dated November 25, 1968, 334 I.C.C. 25, approved a plan of reorganization for the New Haven which it certified to the New Haven Reorganization Court on December 2, 1968. In its opinion of March 17, 1972, the Court of Appeals misunderstood the nature of the proceedings before the New Haven Reorganization Court, stating: "The Commission has never proposed a reorganization plan for the New Haven itself" (A-6). In the *New Haven Inclusion Cases, supra*, this Court, however, recognized that the inclusion of the New Haven's operations in the proposed Penn Central system was the Commission's plan of reorganization for the New Haven, pointing out that "the Commission certified the first step of *its plan* for the reorganization of the New Haven — the sale of its assets to Penn Central — to the reorganization court" on March 29, 1968, 399 U.S. at 413 (emphasis added). On August 13, 1968, as this Court further pointed out, the New Haven Reorganization Court "independently returned *the Commission's plan* for further proceedings," 399 U.S. at 414 (emphasis added). Thereafter, again as pointed out by this Court, "the Commission certified *its revised Plan* to . . . [the New Haven Reorganization Court] on December 2, 1968," 399 U.S. at 416 (emphasis added).

The plan then certified by the Commission provided for inclusion of the New Haven's operating assets in Penn

Central for a consideration to be paid by Penn Central which the Commission found would equal the estimated liquidation value of the assets. The Court of Appeals correctly stated that a Purchase Agreement had previously been entered into among the New Haven Trustees and representatives of the Pennsylvania and New York Central Railroads subject to the approval of the Commission and the New Haven Reorganization Court (A-6). It was incorrect, however, in assuming (as appears to be indicated in its opinion of March 17, 1972 at A-6) that the New Haven Reorganization Court at any time approved the Purchase Agreement as the basis for inclusion of the New Haven in Penn Central. In fact, Judge Anderson rejected the terms of the Purchase Agreement, *In re New York, New Haven and Hartford Railroad Co.*, 289 F. Supp. 451 (D. Conn. 1968), after they had been adopted by the Commission in its first plan of reorganization for the New Haven, 331 I.C.C. 643 (1967). As this Court pointed out in 1970 in the *New Haven Inclusion Cases, supra*, the New Haven Trustees "never submitted the [Purchase] Agreement to that Court [the New Haven Reorganization Court] for its approval." 399 U.S. at 410, n. 46.

The inclusion was ordered by the Commission to take place by January 1, 1969, a date which recognized the New Haven Reorganization Court's earlier finding that continued erosion of the estate from operational losses after that date would constitute an unconstitutional public taking of the New Haven's property without just compensation. 289 F. Supp. at 459.

The New Haven Reorganization Court set December 11, 1968 as a deadline for the filing of objections to the Commission's plan, and fixed December 20, 1968 for a hearing with respect to it. New Haven bondholders interests[3]

[3] Manufacturers Hanover Trust Company, as trustee under the New Haven's First and Refunding Mortgage; the First Mortgage 4% Bondholders' Committee; Oscar Gruss and Son; and Chase Manhattan Bank, N.A., as trustee under the New Haven's General Income Mortgage.

filed extensive objections to the terms determined by the Commission. Penn Central contended that the inclusion should not go forward until the terms of the inclusion had been finally determined.[4]

The bondholders' and Penn Central's objections notwithstanding, the Commission urged that the public interest required inclusion to be effected, with the terms to be reviewed thereafter. (Hearing before New Haven Reorganization Court, December 20, 1968, Transcript, p. 50). By Order No. 559, dated December 24, 1968, the New Haven Reorganization Court approved the Commission's order and ordered the New Haven to make the conveyance, and to accept *pro tanto* the payment of the consideration provided in the Commission's Report and Order. The New Haven Reorganization Court specifically reserved jurisdiction in Order No. 559, as follows:

> "It is *Ordered, Adjudged and Decreed* that the order of the Commission relating to inclusion of Debtor's railroad operations in Penn Central Company on or before January 1, 1969 by conveyance of the Debtor's assets to Penn Central Company and payment of consideration therefor by Penn Central Company, as specified in the Plan, *subject to the jurisdiction reserved in this Order*, is affirmed and the parties are directed to implement said inclusion and payment in compliance with the Commission's order as follows:
>
> * * *
>
> "J. The conveyance of the Debtor's assets by the New Haven Trustee and the payment of consideration by Penn Central Company, as provided herein, shall be without prejudice to the rights of any party to contest the fairness and adequacy of the consideration *and the*

[4] At that time, as this Court subsequently noted: "A condition of . . . [the Penn Central] merger was Penn Central's promise to take in the . . . [New Haven] as an operating entity . . . ." *New Haven Inclusion Cases*, 399 U.S. at 398-399.

other terms of inclusion of the Debtor's operation in Penn Central Company.

"K. *The Court hereby reserves jurisdiction to adjudicate all objections and claims for equitable treatment heretofore filed* herein except that all objections to the inclusion of the Debtor's operations in Penn Central Company as of December 31, 1968 are hereby overruled and denied." (emphasis added)

Penn Central filed a petition for review of the Commission's Order by a statutory three-judge court, and sought, but was denied, an order from that court staying the inclusion. Penn Central did not appeal from the three-judge court order, nor from the New Haven Reorganization Court's Order No. 559.

A description of the background of the inclusion proceedings, the terms of the inclusion, and the subsequent judicial proceedings is set forth in the *New Haven Inclusion Cases*, 399 U.S. at 413-430.

The New Haven's assets were conveyed to Penn Central on December 31, 1968 pursuant to the orders of the Commission and the New Haven Reorganization Court. Subsequently, hearings were resumed by the New Haven Reorganization Court to deal with the issues raised concerning the terms of inclusion. Hearings also commenced before a three-judge district court in the Southern District of New York, to which the New Haven bondholder groups had appealed from the Commission's order.

The New Haven Reorganization Court rejected the Commission's valuation findings, ruling the New Haven's assets to be worth some $29 million more than that determined by the Commission. The New Haven Reorganization Court also met the contentions of the New Haven bondholder groups that they were insecure under the inclusion terms; it did so by formulating and requiring, on its own initiative and as a condition to Section 77's required finding

of fairness and equity, an "underwriting plan" to secure payment to the New Haven equal to the value of the assets conveyed to Penn Central.[5] *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 793, 809 – 810 (D. Conn. 1969).

In its review, the three-judge court, while finding that the Commission's undervaluation was only $990,000, agreed with and also adopted the New Haven Reorganization Court's security device of an underwriting plan to insure that the New Haven would be fully paid for the assets conveyed. *N.Y. N.H. & H.R. Co. Bondholders' Committee v. United States*, 305 F. Supp. 1049 (S.D.N.Y. 1969).

The conflicting decisions of the two district courts were then reviewed by this Court in expedited proceedings. This Court held that the New Haven Reorganization Court was the court of primary jurisdiction, affirming its decision as to the value of the assets sold to Penn Central and as to the constitutional rights of the New Haven creditors to receive payment which represented the fair equivalent in value of those assets. However, after argument in this Court but before its decision, Penn Central itself instituted reorganization proceedings under Section 77 on June 21, 1970, in the United States District Court for the Eastern District of Pennsylvania. This Court stated that, were it not for Penn Central's bankruptcy, it would have affirmed the New Haven Reorganization Court's decision *in toto:*

> "On the basis of the record before the District Court [the New Haven Reorganization Court] at the time of

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[5] The plan provided that Penn Central would pay part of the consideration in the form of common stock (over 950,000 shares), valued by the Commission at $87.50 per share. Since the stock had not yet reached that price on the New York Stock Exchange, the New Haven Reorganization Court provided, in essence, in the underwriting plan that if the stock should not reach that value by February 1, 1978, the New Haven would be entitled to the difference between $87.50 per share and the value of the stock at the conclusion of the underwriting period. *New Haven Inclusion Cases*, 399 U.S. at 486-487.

its order, *we would have no hesitancy in accepting its* findings, conclusions, and *proposed underwriting plan* as consistent with the history of the reorganization proceedings and supported by substantial evidence." 399 U.S. at 488 (emphasis added).

However, specifically in the light of the Penn Central's bankruptcy, this Court disaffirmed the underwriting plan, stating:

"But we cannot avoid the impact of recent events in assessing the propriety of the decree that that court [the New Haven Reorganization Court] has entered. See *United States v. Aluminum Co. of America*, 148 F.2d 416, 445. And those events make it possible that this aspect of the reorganization court's decree may be wholly unrealistic.

"The fairness and equity that are the essence of a §77 proceeding forbid our approval of a payment for the transferred New Haven properties that may be worth only a fraction of its purported value." 399 U.S. at 488.

* * *

"Accordingly, we set aside the order of the Connecticut District Court insofar as it determines that an intrinsic value of $87.50 inheres in the Penn Central common stock and implements *an underwriting plan to secure payment of that sum.*" 399 U.S. at 489 (emphasis added).

Upon receipt of this Court's mandate, the New Haven Reorganization Court, by Order dated August 10, 1970, directed the New Haven Trustee to file a statement of position with respect to the provisions that should be included in the order of remand to the Commission, and provided an opportunity for all interested persons thereafter

to state their positions in light of that taken by the New Haven Trustee.[6] During the course of the ensuing proceedings, the New Haven Trustee took the position, *inter alia*, that pending payment for the properties and rights required by the Commission and The New Haven Reorganization Court to be conveyed to Penn Central on December 31, 1968, the order on remand to the Commission should declare that the property so conveyed was impressed with an equitable lien and that the rights in the so-called Grand Central Terminal Properties and the income therefrom conveyed at the same time were subject to a constructive trust. The underlying reason for this position was to protect the constitutional rights of the New Haven bondholders found by this court.

The New Haven Reorganization Court entered its Memorandum of Decision on June 11, 1971, 330 F. Supp. 131 (A-26 – 60) and its order on June 22, 1971, 331 F. Supp. 212 (A-61 – 65), holding that it had jurisdiction to adjudicate the issues before it and declaring the exist-

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[6] The New Haven Trustee was required to state his position as to six designated subjects: (1) Step II of the plan of reorganization for the New Haven, which deals with the distribution among the New Haven's creditors; (2) the extent and nature of the New Haven Reorganization Court's directions, if any, to the Commission on the remand; (3) declaration of an equitable lien; (4) payment over to the New Haven Trustee of proceeds of sales of mortgaged property on deposit with the indenture trustee under the mortgage securing the Penn Central bonds held by the New Haven Trustee; (5) declaration of a constructive trust; and (6) consummation of the plan of reorganization for Boston and Providence Railroad Corporation. Two of these matters were subsequently resolved and were not treated with in the June 22, 1971 Order of the New Haven Reorganization Court. These involved agreements reached between the New Haven Trustee and the Penn Central Trustees, that were approved by the respective reorganization courts, so that $18 million on deposit under the mortgage securing the Penn Central bonds held by the New Haven Trustee was divided between the two estates; and the acceptance by the Penn Central Trustees of responsibility for carrying out the plan of reorganization for Boston and Providence Railroad.

ence of an equitable lien and constructive trust.[7] The equitable lien was impressed on all the tangible property conveyed to Penn Central with the exception of rolling stock and property theretofore sold by Penn Central. 331 F. Supp. at 215 (A-64). The constructive trust applied to the former right, title and interest of the New Haven in the "Grand Central Terminal Property," but was limited in amount to $28,438,000 plus interest, 331 F. Supp. at 215, 216 (A-64 - 65), the amount upheld by this Court, in affirming the New Haven Reorganization Court, as the value of the New Haven's interest in those properties. 399 U.S. at 445-451.[8]

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[7] On June 21, 1971, upon petition of the Penn Central Trustees, the Penn Central Reorganization Court entered an injunction restraining the New Haven Trustee and others from taking any action pursuant to the Memorandum of Decision or any order entered thereon "to enforce, collect or cause to be perfected or paid any claim against" Penn Central. The Penn Central Reorganization Court also asserted jurisdiction to adjudicate the merits of the equitable lien and constructive trust. The New Haven Trustee and others appealed therefrom to the United States Court of Appeals for the Third Circuit, asserting that the petition of the Penn Central Trustees constituted an impermissible collateral attack on the June 11, 1971 decision of the New Haven Reorganization Court. By decision and order dated December 31, 1971, the Penn Central Reorganization Court extended the injunction and ruled that, pending final resolution of the New Haven estate's entitlement to a security interest in its former property, referring in passing to the proceedings then pending before the Court of Appeals for the Second Circuit (to which this petition for certiorari is addressed), the New Haven Trustee would be deemed to have a tentative lien, "indeterminate in amount, upon all real property and all readily identifiable personal property (except rolling stock) conveyed to the Penn Central as of December 31, 1968, which were still in possession of the Debtor's estate on June 11, 1971," *In the Matter of Penn Central Transportation Company, Debtor*, 337 F. Supp. at 790.

The New Haven Trustee has also appealed that decision to the United States Court of Appeals for the Third Circuit, for the reason, *inter alia*, that it is based upon an impermissible collateral attack on the judgment of the New Haven Reorganization Court; and that the New Haven Reorganization Court's adjudication of an equitable lien and constructive trust was obviously fair and equitable under the circumstances of this case for the reasons stated in Judge Anderson's opinion.

[8] In its Order on Remand, 331 F. Supp. 212 (A-61 — 65), the New Haven Reorganization Court credited against the $174.6 million owed to the New Haven estate some $41.9 million that had heretofore been paid by Penn Central in the form of cash, assumption of liabilities, and cancellation of indebtedness, leaving a balance owed the New Haven estate of $132.7 million. It ruled that the Penn Central stock and bonds that had been delivered to the New Haven, in accordance with the Commission's terms for inclusion, were to be deemed held as security for payment of the balance.

The New Haven Reorganization Court understood this Court's mandate as requiring its adjudication of threshold legal issues before remanding the case to the Commission:

> "This court has the exclusive jurisdiction to determine the effect of the Supreme Court's mandate in the *New Haven Inclusion Cases*, and this court must decide what is to be done to implement it. The full price required to be paid for the New Haven's assets was decided, but the terms of payment were not; and this court alone must review and determine what means, pursuant to the Supreme Court's mandate, are proper. The I.C.C. cannot adjudicate the issues of law now before this court, for these lie outside its jurisdiction. . . .
>
> "So here, the Commission has no jurisdiction to decide the legal questions of the New Haven's status, whether as that of a stockholder or creditor, including the type of creditor, and the further related question as to whether or not the New Haven estate has a full security interest in its former properties for the balance of the purchase price. These are legal questions which are for this court in construing the Supreme Court's mandate. In the circumstances of this case ordinary sense and logic call for a resolution of these paramount issues before remand of the case to the I.C.C. in order that it may proceed with prior knowledge of how the legal questions have been adjudicated. 330 F. Supp. at 136-137 (A-28 – 29).

While then adjudicating that an equitable lien and constructive trust existed, the New Haven Reorganization Court did not enter any order which enforced the lien or trust (providing only that a formal accounting of the income subject to the trust was required), stating:

> ". . . the Penn Central reorganization court will remain wholly in control of the effect, if any, of such a lien on the operations of the railroad and on its reorganization plan formulation." *Id.* at 137 (A-31).

The Penn Central Trustees, Manufacturers Hanover Trust Company, as trustee under the New York Central and

Hudson River Railroad Co. Gold Bond Mortgage, and Penn Central Transportation Company appealed to the Court of Appeals for the Second Circuit. The Court of Appeals' decision reversed the New Haven Reorganization Court on jurisdictional grounds and directly remanded the case to the Commission.[9]

The Court of Appeals recognized that the New Haven Reorganization Court had specifically held that it had jurisdiction to enter its order. The Court of Appeals summarized four bases upon which it had been contended that jurisdiction could be premised, as follows: "First . . . the 'exclusive jurisdiction' provision of §77 (a) cannot be read literally, and the . . . [New Haven Reorganization Court's] action comports with the policy underlying that section. Second . . . [the New Haven Reorganization Court] had jurisdiction to implement the Supreme Court's mandate in the *New Haven Inclusion Cases*. Third . . . [the New Haven Reorganization Court] reserved jurisdiction, in its order authorizing the transfer of the New Haven estate's assets, over the property so transferred. Finally . . . [the New Haven Reorganization Court] had *in personam* jurisdiction over the Penn Central trustees and thus had the power to adjudicate the rights of the parties in property not located within the court's territorial jurisdiction." (A-11).

The Court of Appeals rejected all four bases of jurisdiction, wholly relying on its view of the rationale of *Warren v. Palmer, supra*.[10] It did not find that the New Haven Reorganization Court's order *would*, but only, despite its clear statement of intent that enforcement of the security and control over rail operations would remain in the Penn Central Reorganization Court, that such order *could:*

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[9] "Reversed and remanded to the Interstate Commerce Commission" (A-19).

[10] See page 23, *infra*.

> " . . . at this stage of the Penn Central reorganization proceedings, seriously impair the formulation of a workable plan for the financial resuscitation of Penn Central by the Commission and the ability of the Pennsylvania reorganization court to administer the entire Penn Central system, of which the New Haven line is but a division . . ." (A-16).

This finding, even as limited by the Court of Appeals to an area only of possibility of interference, was without the support of any evidentiary record. Further, in his concurring opinion, Judge Mansfield watered down even the possibility of any interference, characterizing the effect of the security, as follows:

> "Although the creation of a lien and a constructive trust upon assets of the Penn Central might not have the immediate effect of disrupting that court's operation of the railroad, such action *could pose the threat* of doing so." [11] (A-20) (emphasis added.)

The Court of Appeals held, under *Warren v. Palmer, supra*, that the New Haven Reorganization Court had been ousted from substantially *all* jurisdiction over the New Haven reorganization proceedings by the adjudication of Penn Central's bankruptcy (A-13; A-16). The Court of Appeals held that a plan of reorganization for the New Haven should be formulated by the Commission only in conjunction with a plan of reorganization for Penn Central and,

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[11] The "threat" of interference referred to by Judge Mansfield could, if at all, only concern the constructive trust on one half the "excess income" from the Park Avenue properties, since the order of the New Haven Reorganization Court regarding the equitable lien required no act by the Penn Central Trustees. It is significant, therefore, that the Penn Central Trustees have stated subsequently in petitions to the Penn Central Reorganization Court for approval of the sale of certain of the Park Avenue properties, that the properties and income from such properties "are not required by the [Debtor's] Trustees in the operation of the Debtor's railroad or in the conduct of the Debtor's transportation business." (Penn Central Trustees' petitions attached to Order No. 605, dated March 13, 1972, of the Penn Central Reorganization Court.)

in effect, that the Penn Central Reorganization Court alone had jurisdiction to pass upon the fairness and equity of the New Haven's reorganization plan (A-18 – 19). It remanded "the case to the Interstate Commerce Commission with directions to consider, in light of the Penn Central reorganization, the form of consideration the New Haven estate should receive" [12] (A-19).

The Court of Appeals stressed that its reversal of the New Haven Reorganization Court was limited to its disagreement as to jurisdiction:

> "We do not imply by this remand that we disagree either with the fairness of Judge Anderson's order or with his conclusion that the Supreme Court's opinion in *New Haven Inclusion Cases* requires that the New Haven estate receive $174.6 million as compensation for the taking of its property. We hold only that the Connecticut reorganization court is not the proper body to grant whatever protection is required because it has no jurisdiction . . . " (A-19).

While thus refraining from an adjudication as to the merits of the New Haven Reorganization Court's judgment, the effect of the jurisdictional holding, nevertheless, is to deprive the New Haven of the security which was deemed necessary by the New Haven Reorganization Court to meet the requirements of the remand by this Court. Thus, the substantive impact of the Court of Appeals' decision is to continue without any protection for an indefinite period the creditors' rights which, in the *New Haven Inclusion Cases, supra*, this Court held must under the Constitution be adequately safeguarded.

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[12] Judge Mansfield did not concur in this holding, stating ". . . I do not agree that the Commission and the Pennsylvania Court have the power unilaterally and without approval of the Connecticut court to determine the form of the consideration that is to be paid to the New Haven estate and its creditors for the assets transferred to the Penn Central." (A-20)

REASONS FOR GRANTING THE WRIT

Summary

This Court should grant certiorari because the central issues in this case concern the proper construction and implementation of this Court's mandate in the *New Haven Inclusion Cases, supra.* Utterly divergent decisions interpreting that mandate have been rendered by the New Haven Reorganization Court and the Court of Appeals. Only this Court can construe its mandate with finality.

This case also involves important questions of railroad reorganization law which have not heretofore been considered and which ought to be decided by this Court. The issues include matters pertinent to the public interest in soundly financed railroads and such matters of expressed national transportation policy as

> " . . . promot[ing] the public interest in increased stability of values of railroad securities with resulting greater confidence therein of investors, . . . assur[ing], insofar as possible, continuity of sound financial condition of common carriers [and] . . . enhanc[ing] the market ability of railroad securities . . . " 49 U.S.C.A. 20b, Historical Note.

If the Court of Appeals decision is allowed to stand, the public interest in carrying out the national transportation policy will be adversely affected. There are currently six pending major Section 77 reorganizations[13] in the Northeast alone, and the issues raised by the Court of Appeals' decision have substantial relevance not only to the rights of holders of railroad securities in these reorganizations, but are related directly to the future ability of all railroads economically and efficiently to finance their operations. This

[13] The New York, New Haven and Hartford Railroad Company, Penn Central Transportation Company, Boston and Maine Corporation, Central Railroad Company of New Jersey, Lehigh Valley Railroad Company and Reading Company.

Court should grant certiorari to resolve the conflicts between the decisions of the Court of Appeals and the decisions of this Court both in the *New Haven Inclusion Cases, supra*, and in *Warren v. Palmer, supra*, and to scrutinize carefully the ouster of the New Haven Reorganization Court of substantially all of its reorganization jurisdiction, including the power to protect the New Haven estate through the security devices of an equitable lien and constructive trust.

In brief, the decision of the Court of Appeals misconstrues this Court's mandate; invades the constitutional rights of the New Haven creditors; misapplies *Warren v. Palmer, supra;* ousts the New Haven Reorganization Court of substantive jurisdiction over the New Haven reorganization; produces an unjust enrichment of other Penn Central creditors; and leaves the New Haven estate at the mercy of an eroding and wasting Penn Central estate.

1. *Only This Court Can Construe With Finality Its Opinion and Judgment in The New Haven Inclusion Cases, Supra, and Can Set Forth Its Intention in Directing Its Remand to The New Haven Reorganization Court.*

This Court rendered its opinion in the *New Haven Inclusion Cases, supra*, on June 29, 1970, and remanded the case to the New Haven Reorganization Court. Penn Central had gone bankrupt on June 21, 1970. Cognizant of this Court's approval in the *New Haven Inclusion Cases, supra*, of his role ("The chancellor remains 'a necessary and important factor in railroad reorganization,'" 399 U.S. at 433), Judge Anderson presided over proceedings for some ten months with respect to what could and should be done pursuant to the remand and the Penn Central's bankruptcy. Following those proceedings Judge Anderson entered his opinion and order adjudging an equitable lien and construc-

tive trust on the former New Haven property to protect the New Haven estate and its creditors, and to prevent Penn Central's other creditors from being unjustly enriched.

The Court of Appeals reversed, holding that the New Haven Reorganization Court had no jurisdiction under the mandate by reason of the superior jurisdiction of the Penn Central Reorganization Court, and was powerless to declare the security measures constituted by the equitable lien and constructive trust. Yet this Court, with full knowledge of and specific reference to the pendency of the Penn Central reorganization proceedings, *New Haven Inclusion Cases, supra*, 399 U.S. at 399 n., remanded the case to the New Haven Reorganization Court (and not to the Commission or the Penn Central Reorganization Court). Only this Court can clarify whether it intended the court to which it directed its mandate to have jurisdiction limited solely to a ministerial forwarding of this matter to the Commission and, thereafter, to be barred from all substantive implementation of the mandate.

The New Haven Reorganization Court considered that the mandate required it, in remanding the case to the Commission, to adjudicate pertinent threshold legal issues, noting that the Commission has itself held that it had no power to adjudicate legal rights *inter partes, Boston and Providence Railroad Reorganization Proceedings*, 290 I.C.C. 363, 382 (1954); 327 I.C.C. 10, 15 (1966).[14] It also considered that it had been directed to formulate an appropriate security device to replace the "underwriting plan" which had been rejected by this Court. The "underwriting plan," which had itself been the invention of the New Haven Reorganization Court in the earlier phase of the pro-

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[14] See also this Court's opinion in the *New Haven Inclusion Cases* on the extraordinary powers of a Section 77 reorganization court and on the Commission's lack of power to decide legal issues. 399 U.S. at 433-434, 442.

ceeding (and was then accepted by the Commission without any further administrative findings), was specifically found by this Court not to provide adequate security for the very reason that the Penn Central reorganization had been instituted. *New Haven Inclusion Cases*, 399 U.S. at 488, 489. Accordingly, only this Court can resolve whether the New Haven Reorganization Court's formulation of new security measures, as well as whether the measures which it formulated, were a proper fulfillment of its responsibilities under this Court's mandate, Section 77, and its own retained jurisdiction.

2. *The New Haven Reorganization Court Had Jurisdiction Under This Court's Remand to Protect The Constitutional Rights of The New Haven Creditors, and The Equitable Lien and Constructive Trust Were Appropriate Security Devices for That Purpose.*

Constitutional rights of secured creditors of the New Haven estate as to the former New Haven property, previously determined by this Court, may be irreparably impaired by any delay in resolution of the issues in the case at bar.

There has been a material and continuing erosion of Penn Central assets during its operation in reorganization. In the absance of a determination that the New Haven has at least a security interest (even one, as here, which is wholly limited in extent to the New Haven's own former property for which it has not received the payment found by this Court to be fair and equitable), the continuing erosion of the Penn Central estate will necessarily visit a disproportionate and permanent reduction in the New Haven's claim vis-a-vis other secured creditors. Recognizing the strictures of *Warren v. Palmer, supra*, against interfering with Penn Central *operations*, the equitable lien and constructive trust were among a severely limited group of, if not the only, mea-

sures available to the New Haven Reorganization Court to protect the New Haven creditors' rights against those of other creditors of Penn Central seeking the benefit of the former New Haven assets.

In the *New Haven Inclusion Cases*, *supra*, this Court held (affirming the judgment of the New Haven Reorganization Court) that the New Haven creditors have suffered all the losses they were required to suffer in the public interest and that any further losses would be an unconstitutional taking of their property without just compensation, 399 U.S. at 466. This Court stated that no further loss by the New Haven creditors could be sustained under any construction of the Bankruptcy Act, *Id.* at 467.

Acting pursuant to the mandate, and aware of the Commission's lack of legal power to declare security interests in the former New Haven property to protect the creditors' constitutional rights to be paid therefor, the New Haven Reorganization Court considered it was required to formulate new security measures to replace the disaffirmed "underwriting plan." In devising the new security measures, the New Haven Reorganization Court fully appreciated that the security devices would not carry complete assurance of payment and that the ostensible conflict between the "exclusive jurisdiction" of the two reorganization courts over the same *res* must be avoided. Thus, it was careful to find the path which would avoid any actual, or even any reasonably warranted inference of, interference with the Penn Central Reorganization Court's control over Penn Central's operations, pointing out that:

> " . . . the Penn Central reorganization court will remain wholly in control of the effect, if any, of such a lien on the operations of the railroad and on its reorganization plan formulation." 330 F. Supp. at 137 (A-31).

A significant constitutional question is raised whether there is an interference as a matter of law with the *operations* of Penn Central, as found by the Court of Appeals, from the provision of the security protection afforded by the equitable lien and constructive trust. This security protection will clearly be particularly important during the time it will take the Commission to formulate a final plan of reorganization for the New Haven and for that plan to be approved, confirmed and consummated. The question whether creditors who have been found to have sustained the constitutional limits of permissible loss in one railroad reorganization are obliged to subject their remaining assets to the risk of further loss in the reorganization operations of a second railroad because the public interest required their rail assets to continue to be operated by the second railroad, fairly should be resolved as quickly as possible.

The Court of Appeals' failure to pass on the substantive issue, and the resulting lack of security for the New Haven's constitutional right to receive payment, will result in a windfall for other Penn Central creditors who will reap the benefits (even as to proceeds of sale) of the former New Haven assets, without ever having paid for those assets. Further, if the New Haven estate is not now protected by adequate security measures during the time a plan of reorganization for Penn Central is being formulated and approved, the New Haven estate might be so eroded as to leave nothing for New Haven creditors, except those qualifying as administration claimants in the New Haven reorganization proceedings. It is thus imperative for the protection of the New Haven bondholders for this Court to grant certiorari to adjudicate now the merits of the equitable lien and constructive trust as security measures implementing this Court's mandate to protect the New Haven creditors' constitutional rights.

3. The Court of Appeals Misapplied Warren v. Palmer and Misconstrued its Application to the Respective Roles of the Reorganization Courts and the Commission.

In *Warren v. Palmer, supra*, this Court held that, where one reorganization court had authorized the rejection of a leased line but the debtor was required to continue operations on that line, the reorganization court charged with operations could impose a lien on the former leased line to protect the debtor from operational losses, although the lessor was itself in reorganization under Section 77 in another court.

The New Haven Reorganization Court concededly had jurisdiction over the New Haven properties for the more than seven years prior to the conveyance of the properties to Penn Central on December 31, 1968, and clearly and specifically retained jurisdiction in its order authorizing the conveyance to adjudicate subsequently matters relating to the purchase price to be paid by Penn Central. This retained jurisdiction was recognized by this Court when it sent its mandate to the New Haven Reorganization Court. The Court of Appeals' decision, which relies on *Warren v. Palmer, supra*, to oust the New Haven Reorganization Court of its primary jurisdiction over the New Haven reorganization proceedings, raises questions of far reaching importance of railroad reorganization law and the relationship between courts having concurrent jurisdiction over the same *res*. Clarification of the scope of application of *Warren v. Palmer, supra*, which, contrary to the view of the Court of Appeals here, indeed preserved concurrent jurisdiction of two railroad reorganization courts, is desirable.[15]

[15] The concurring opinion, while refusing to go so far as the majority and which attempted to find, without prescription, some continuing jurisdiction for the New Haven Reorganization Court, actually creates an even more difficult legal issue. It would relegate to the Commission, in effect, the power to determine which district court has what jurisdiction in the subsequent proceedings affecting the New Haven (A-23 — 24).

In the instant case, the New Haven Reorganization Court carefully applied *Warren v. Palmer, supra*, and protected the Penn Central Reorganization Court's control over Penn Central *operations* of the former New Haven properties by specifically providing that the equitable lien and constructive trust on such properties could be enforced only in that court. The disagreement of the Court of Appeals with this reasonable and functional application of the decision in *Warren v. Palmer, supra*, should be reviewed and rejected.

The distinctions between the respective functions of the Commission and a reorganization court as to the same *res* were set forth by this Court by its opinions in *Ecker v. Western Pacific R. Corp.*, 318 U.S. 448 (1943), and the *New Haven Inclusion Cases, supra*. This necessary kind of delineation is presently lacking, however, where the respective functions of two reorganization courts are involved. The present case squarely raises issues which test the degree to which *Warren v. Palmer, supra*, may, if at all, be extended. Contrary to the unqualified, simplistic application of *Warren v. Palmer* by the Court of Appeals, the New Haven Reorganization Court's view of *Warren v. Palmer* establishes a division of function between the respective reorganization courts on the one hand, and among them and the Commission on the other, which recognizes the public interest, and protects the individual constitutional rights of New Haven creditors involved.

For example, in the instant case, the division of functions among the two courts and the Commission would be as follows: The New Haven Reorganization Court should adjudicate, as it already has, matters as to which the Commission has no jurisdiction, i.e., questions of legal rights between parties. In the instant case that adjudication involved the determination that the New Haven creditors were constitutionally entitled to be equitably secured in their right to payment for the assets taken from them, free

from the lien of their mortgages, because of the public interest in continued rail operation. Based upon that adjudication, the Commission, and not the reorganization court, would then decide the valuation questions, capitalization, if pertinent, and related matters. After determination by the Commission in this instance of a plan of reorganization for the New Haven under Section 77 which fairly and equitably treated with those questions, it would certify the same to the New Haven Reorganization Court for the normal course of review under Section 77.

Since, however, in the instant case, the plan of reorganization for the New Haven would involve payment by another railroad also in reorganization under Section 77, the Penn Central Reorganization Court would in due course pass upon the treatment of the New Haven estate's claim (whose amount and form would have already been established by the Commission and the New Haven Reorganization Court) as part of the reorganization plan for Penn Central certified to it by the Commission. In such latter review, the New Haven's established claim would be subject to the impact, as determined by the Commission and the Penn Central Reorganization Court, of the Penn Central reorganization plan on claims of the same rank, priority, and security.

The only qualification on these divisions of functions would be that, as in *Warren v. Palmer, supra*, if the New Haven's established claims took a form which actually interfered with *the operations* of Penn Central, the Penn Central Reorganization Court would have *exclusive jurisdiction*, to determine, the extent of the same, and the protection required in the public interest against the interference. As previously indicated, the New Haven Reorganization Court was wholly sensitive to the exclusive jurisdiction of the Penn Central Reorganization Court to control both Penn Central operations and the ultimate treatment in a reorganization plan for Penn Central of a New Haven claim protected by

a limited equitable lien and constructive trust. While the Court of Appeals assumed that these security devices adversely affected the operations of Penn Central, there was no showing that any such impact has occurred or could occur. And, in fact, none has.

The only certain and intended effect of the judgment of the New Haven Reorganization Court is that the New Haven's claim to be paid for the property which it conveyed to Penn Central pursuant to Commission and court order, and before final adjudication of the price and terms, would, as limited to that property, have priority over other non-administration secured claims and the claims of general creditors of Penn Central. Where the security provided is limited wholly to the property and rights conveyed, not only is the mere existence of such security interest demonstrably not injurious to the conduct of Penn Central's operation in reorganization, but it is equitably justified. Only a person having a claim which arose subsequent to December 31, 1968 in specific reliance upon the New Haven's lack of an equitable security interest in the former New Haven assets could claim otherwise; but such a contention could not equitably be sustained in view of the continued existence, from a date even preceding the conveyance, of the litigation with respect to the amount and terms of payment for the property.

Without this Court's determination of the applicability to the instant case of *Warren v. Palmer*, the confusion that must result as to the future proceedings in the New Haven reorganization has the seeds of further confusion compounded in other Section 77 proceedings now in process in

reorganization courts in the first and third circuits.[16]

4. The Court of Appeals Ouster of The New Haven Reorganization Court From its Substantive Jurisdiction is Unprecedented; and Will Unduly Prolong The New Haven Reorganization Proceedings.

The public interest, the interest of investors, and national transportation policy require that reorganization plans under Section 77 be formulated and consummated with the greatest possible speed. At best, much time is consumed. The Court of Appeals cited with approval, however, the Commission's stated intention to "consolidate the Penn Central reorganization and New Haven inclusion proceedings so as to consider the terms of the New Haven inclusion as 'a portion of the reorganization of Penn Central . . . ' " (A-19), and remanded the case to the Commission for this purpose. In thus ousting the New Haven Reorganization Court from jurisdiction over the New Haven reorganization after more than ten years, and subjecting New Haven creditors to a new reorganization of indefinite but lengthy duration, the Court of Appeals would protract the New Haven reorganization proceedings to a seemingly endless pro-

[16] The Court of Appeals seeks to avoid jurisdictional conflicts by assigning related reorganizations to the same court. However, substantial and difficult §77(a) jurisdictional problems arise when the same court supervises two related reorganizations as well as when two different courts must delineate their respective jurisdictions over the same *res*. For example, in the case of the Lehigh Valley Railroad Company, Debtor, whose separate reorganization proceedings are supervised by the same court which supervises the Penn Central reorganization, it appears that Penn Central is not presently being paid regular interline operating balances by Lehigh Valley (see *Lehigh Valley Railroad Company Abandonment Between Dushore and Towanda, Pa.* 338 I.C.C. 793, 797 (1972). Thus, creditors of Penn Central, as well as creditors of Lehigh Valley, have to face the question of the capacity in which the same Section 77 reorganization court will determine how respective creditors of a bankrupt parent and its bankrupt subsidiary are to be protected in their respective operations.

cess.[17] Consolidation of the two proceedings clearly would eliminate any possibility of a completion of the New Haven proceedings prior to completion of the Penn Central reorganization and, in fact, may even have the effect of postponing a New Haven reorganization under such circumstances until after completion of the Penn Central reorganization.

The stated objective of the Court of Appeals' decision is to vest in another district court the precise issue that this Court held in an analogous context would be best adjudicated in the New Haven Reorganization Court:

> "We therefore hold that the three-judge court here should have granted the Government's motion to the extent of deferring to the reorganization court in proceedings ultimately involving only the price to be paid for the assets of the debtor's estate." *New Haven Inclusion Cases*, 399 U.S. at 430.

The New Haven Reorganization Court's knowledge and expertise in this matter, which has been pending before it for more than ten years, are unmatchable in expediting the termination of the New Haven reorganization proceedings. It is the only court with a complete record before it of New Haven participation in proceedings which have been involved in various appellate aspects in this Court on three prior occasions.[18] If the New Haven proceedings were to become

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[17] On April 3, 1972, the Penn Central Trustees reported to the Penn Central Reorganization Court that they would not file a plan for reorganization of Penn Central prior to April 1973, and that their present studies are based upon operating conditions estimated to exist in 1976. The proceedings before the Commission leading to approval and certification of a plan to the district court under these circumstances and the latter's subsequent approval and confirmation proceedings may reasonably be assumed to require many years to complete.

[18] *New Haven Inclusion Cases, supra; Penn Central Merger and N & W Inclusion Cases*, 389 U.S. 486 (1968); *Baltimore & Ohio R.R. v. United States*, 386 U.S. 372 (1967).

subject to review in the Penn Central Reorganization Court, as directed by the Court of Appeals, the evidence of the past ten years would be required in large measure again to be prepared, offered and considered *de novo*. This procedure would produce further adverse consequences to the objective of efficient, economical administration of the bankruptcy laws, already sorely tried in a number of cases, without any concomitant legal or public gain. Such a result in itself warrants the review of, and promulgation of guiding principles by, this Court concerning the questions presented.

Affirmance of the New Haven Reorganization Court's appropriate jurisdiction in the premises as to New Haven matters other than those affecting the operations of the Penn Central system would appear to make possible the formulation and carrying out of a plan of reorganization for the New Haven which need not wait upon the completion of the reorganization of Penn Central. To be sure, the actual receipt by the New Haven of payment for its properties conveyed to Penn Central could be years in the future and would, in any event, depend on the treatment for secured creditors of the New Haven's rank, priority, and security, as ultimately approved by the Penn Central Reorganization Court in a plan for Penn Central.[19] However, once the pending question as to the form and characteristics of the New Haven claim has finally been resolved, e.g., whether and how and in what amount the claim is deemed equitably secured, the final determination by the Commission of a plan for equitable treatment of the creditors' claims in the New Haven's own reorganization and the approval of such plan by the New Haven Reorganization Court may be achieved with a minimum of delay.

[19] As this Court pointed out at the beginning of its opinion in the *New Haven Inclusion Cases*, in noting the institution of the Penn Central's reorganization proceedings: "Whether the financial obligations dealt with in the present opinion may become subject to modification in or because of those proceedings is a question with which the present opinion in no way deals," 399 U.S. at 399 n.

CONCLUSION

For the foregoing reasons, this Petition for Writ of Certiorari should be granted in order for this Court to review the jurisdictional judgment of the Court of Appeals and the substantive merits of the equitable lien and constructive trust adjudicated by the New Haven Reorganization Court.

Respectfully submitted,

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Dated: April 28, 1972

APPENDIX

STATUTES INVOLVED

Section 77. Reorganization of Railroads Engaged in Interstate Commerce. — (a) Any railroad corporation may file a petition stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. The petition shall be filed with the court in whose territorial jurisdiction the corporation, during the preceding six months or the greater portion thereof, has had its principal executive or operating office, and a copy of the petition shall at the same time be filed with the Interstate Commerce Commission (hereinafter called the "Commission"). When any railroad, although engaged in interstate commerce, lies wholly within one State, the proceedings shall be brought in the United States district court for the district in which its principal operating office has been located during the preceding six months or the greater portion thereof. The petition shall be accompanied by payment to the clerk of a filing fee of $150. Upon the filing of such a petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that it complies with this section and has been filed in good faith, or dismissing it, if he is not so satisfied. If the petition is so approved, the court in which the order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a court of the United States would have had if it had appointed a receiver in equity of the property of the debtor for any purpose. Process of the court shall extend to and be valid when served in any judicial district. The Supreme Court of the United States shall promulgate rules relating to the service of process outside of the district in which the proceeding is pending, and any other rules which it may deem advisable in order to aid district

courts and courts of appeal in exercising the jurisdiction herein conferred upon them. The railroad corporation shall be referred to in the proceedings as a "debtor." Any railroad corporation the majority of the capital stock of which having power to vote for the electioon of directors is owned, either directly or indirectly through an intervening medium, by any railroad corporation filing a petition as a debtor may file, with the court in which the other debtor has filed such a petition, and in the same proceeding, a petition, a copy of which shall also be filed at the same time with the Commission, stating that it is insolvent or unable to meet its debts as they mature, and that it desires to effect a reorganization in connection with, or as a part of the plan of reorganization of the other debtor; and upon the filing of the petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that it complies with this section and has been filed in good faith, or dismissing it if not so satisfied, and thereupon the court, if it approves the petition, shall have the same jurisdiction with respect to such debtor, its property and its creditors and stockholders, as the court has with respect to the other debtor. Creditors of any railroad corporation, having claims aggregating not less than 5 per centum of all the indebtedness of the corporation as shown in the latest annual report which it has filed with the Commission at the time when the petition is filed, may, if the corporation has not filed a petition under this section, file with the court in which the corporation might file a petition under this section, a petition stating that the corporation is insolvent or unable to meet its debts as they mature and that the creditors have claims aggregating not less than 5 per centum of all such indebtedness of the corporation and propose that it shall effect a reorganization; copies of the petition shall be filed at the same time with the Commission and served upon the corporation. The corporation shall, within ten days after such service, answer the petition. If the

answer admits the jurisdiction of the court and the material allegations of the petition, the judge shall enter an order approving the petition as properly filed if satisfied that it complies with this section and has been filed in good faith, or dismissing it, if not so satisfied. If the answer denies either the jurisdiction of the court or any material allegation of the petition, the judge shall summarily determine the issues presented by the pleadings without the intervention of a jury, and if he finds that the material allegations are sustained by the proofs and that the petition complies with this section and has been filed in good faith, the judge shall enter an order approving the petition; otherwise, he shall dismiss the petition. If such a petition is so approved, the proceedings thereon shall continue with like effect as if the railroad corporation had itself filed a petition under this section. If a petition is dismissed, neither the petition nor the aswer of a debtor constitute an act of bankruptcy or an admission of insolvency or of inability to meet maturing obligations or be admissible in evidence, without the debtor's consent, in any proceedings then or thereafter pending or commenced under this Act or in any State or United States court. If, in any case in which the issues have not already been tried under the provisions of this subdivision, any of the creditors, prior to the hearing provided for in paragraph (1) of subsection (c) of this section, appear and controvert the facts alleged in the petition, the judge shall determine, as soon as may be, the issues presented by the pleadings, without the intervention of a jury, and, unless the material allegations of the petition are sustained by the proofs, shall dismiss the petition.

Section 77(c) Reorganization of Railroads Engaged in Interstate Commerce.

(6) If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the

lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee to continue operation on or for the account of the lessor until the abandonment of such line is authorized in accordance with the provisions of section 1 of the Interstate Commerce Act as amended, or until such operation pursuant to this paragraph is otherwise lawfully terminated. During any such operation, the lessor shall be deemed to be a carrier subject to all applicable provisions of the Interstate Commerce Act, as amended, and shall be entitled to receive just, reasonable, and equitable divisions of rates, fares, or charges applicable to the transportation of persons or property over its line or lines of railroad and the lines of the lessee or other carriers, and the provisions of section 15(6) of the Interstate Commerce Act, as now or hereafter amended, shall apply to said divisions whether or not joint rates covering such transportation have been established.

United States Court of Appeals

For the Second Circuit

Nos. 372, 373, 374 — September Term 1971.
(Argued January 3, 1972 Decided March 17, 1972.)
Docket Nos. 71-1903, 71-1929, 71-2024

In the Matter of
THE NEW YORK, NEW HAVEN AND
HARTFORD RAILROAD COMPANY,

Debtor.

Before:

LUMBARD, HAYS and MANSFIELD,

Circuit Judges.

HAYS, *Circuit Judge:*

This is an appeal from an order of the United States District Court for the District of Connecticut declaring an equitable lien on certain property and imposing a constructive trust on income from certain other property transferred by the debtor New York, New Haven and Hartford Railroad (New Haven) to the Penn Central Transportation Company (Penn Central). We reverse on the ground that the district court lacked subject matter jurisdiction under §77(a) of the Bankruptcy Act, 11 U.S.C. §205(a) (1970), to issue the order, since the property affected is within the exclusive jurisdiction of another district court.

This appeal involves one more stage in the lengthy and complicated proceedings involving the reorganization of the New Haven, the merger of the Pennsylvania Railroad

and the New York Central Railroad to form the Penn Central, the inclusion of the New Haven's lines in the merged Penn Central, and Penn Central's subsequent petition for reorganization. An outline of the various proceedings from 1961 to 1969 is set forth in *New Haven Inclusion Cases*, 399 U.S. 392, 399-418 (1970). See also *Penn-Central Merger and N & W Inclusion Cases*, 389 U.S. 486 (1968) and *Baltimore & Ohio R.R.* v. *United States*, 386 U.S. 372 (1967). For purposes of this appeal, a brief outline of the previous proceedings will suffice.

In July, 1961, New Haven filed a petition for reorganization pursuant to §77 of the Bankruptcy Act, 11 U.S.C. §205 (1970), in the United States District Court for the District of Connecticut. The court approved the petition and appointed trustees. In March, 1962 the Pennsylvania and New York Central railroads applied to the Interstate Commerce Commission for permission to merge. In June, 1962 the New Haven trustees filed with the Commission a petition for inclusion in the proposed merged railroad. The Commission has never proposed a reorganization plan for the New Haven itself. In 1966 the Commission approved the merger of the Pennsylvania and New York Central but required as a condition of approval of the merger that the New Haven's lines be included in the merged railway system. The New Haven trustees and representatives of the Pennsylvania and New York Central railroads thereupon entered into a Purchase Agreement, subsequently modified, which provided that all the New Haven assets would be transferred to Penn Central in return for cash, and stock and bonds of Penn Central. The New Haven trustees requested the Connecticut reorganization court to permit them to petition the Commission to require inclusion of the New Haven's lines in the merged rail system on the terms set forth in the Purchase Agreement. The Connecticut reorganization court granted permission, and in 1967 the

Commission approved inclusion on the terms provided in the Purchase Agreement. Subsequent litigation dealt with the proper value to be assigned to the New Haven properties. On December 24, 1968, however, because of the precarious financial condition of the New Haven and the imminent termination of its rail service, the Connecticut reorganization court approved the transfer of New Haven's assets to Penn Central, leaving the exact amount and form of consideration to be paid by Penn Central to be settled finally at a later date. Since the Commission conditioned approval of the merger on inclusion of the New Haven, Penn Central, as a result of the merger, consented to be bound by "whatever terms the [Connecticut] reorganization court might [later] confirm . . ." *New Haven Inclusion Cases*, supra at 428. However the transfer of New Haven's assets was expressly made "free and clear of all liens, charges and encumbrances."

The decision of the Supreme Court in *New Haven Inclusion Cases*, handed down on June 29, 1970, upheld the determination of the Connecticut reorganization court that the value of the New Haven property transferred to Penn Central was approximately $174.6 million. Under the Purchase Agreement, an object of which was to assure that the New Haven estate would actually receive full compensation, a portion of the consideration was to be paid to the New Haven estate in the form of Penn Central stock and bonds. Because of mounting financial pressures, however, the market value of Penn Central stock declined drastically from the date of the first negotiations between New Haven and Penn Central representatives and the final inclusion of the New Haven in the merger. See *In re New York, N.H. & H. R.R.*, 304 F. Supp. 793, 808-810 (D. Conn. 1969); *New York, N.H. & H. R.R. Co. First Mortgage 4% Bondholders' Committee* v. *United States*, 305 F. Supp. 1049, 1064-65 (S.D.N.Y. 1969). See also *Pennsylvania Railroad Co.—Merger—New York Central Railroad Co. (Fifth*

Supplemental Report), 334 I.C.C. 528, 532 (1969). The Supreme Court, therefore, while agreeing with the Connecticut reorganization court's valuation, remanded the case for "[f]urther proceedings before the Commission and the appropriate federal courts . . . to determine the form that Penn Central's consideration to New Haven should properly take . . ." *New Haven Inclusion Cases*, supra at 489.

On June 21, eight days before the Supreme Court's decision was announced, Penn Central filed a petition for reorganization in the Eastern District of Pennsylvania. The petition was approved the same day and the district court issued an order restraining and enjoining all persons "from interfering with, seizing, converting, appropriating, attaching, garnisheeing, levying upon, or enforcing liens upon, or in any manner whatsoever disturbing any portion of the assets . . . properties or premises belonging to, or in the possession of the Debtor [Penn Central] . . . and from commencing or continuing any proceeding against the Debtor" with certain exceptions not here relevant.

After receiving the mandate of the Supreme Court, the Connecticut reorganization court did not remand to the Commission for further proceedings. Instead, it ordered, on August 10, 1970, that a hearing be held on the question of whether the court should modify its prior orders with respect to the New Haven assets previously transferred to Penn Central. The Penn Central trustees appointed by the Pennsylvania reorganization court appeared at the hearing, although they were not parties to the New Haven reorganization. After various proceedings extending over approximately ten months, the Connecticut reorganization court issued a decision on June 11, 1971. The court first held, on various grounds, that it had subject matter jurisdiction. Because the decline in the market price of Penn Central stock and Penn Central's pending reorganization had rendered the court's plan for compensation for the New

Haven property grossly inequitable, the court declared that, in order to implement the Supreme Court's mandate to compensate fully "the New Haven estate for the balance [of the purchase price] remaining due and to provide reasonable security for the sum owed,"

> "(1) . . . the 956,576 shares of common stock of the Penn Central Company, the parent company, should be treated as collateral security, of indeterminate value, for the balance of the purchase price due by the Penn Central Trustees; it is wholly unrealistic to treat the stock otherwise; (2) that an equitable lien must be declared on all of the former assets transferred by the New Haven to Penn Central, exclusive of (a) rolling stock and (b) the New Haven's one-half interest in the excess income from the Grand Central [Terminal] properties; and (3) that the Penn Central Trustees hold the latter item of property subject to a constructive trust in favor of the New Haven estate."

The reasoning of the district court was that, as the Supreme Court had determined that the New Haven estate had the constitutional right to receive $174.6 million for the assets transferred to the Penn Central, the New Haven estate could not be relegated to the position of a general creditor in the pending Penn Central reorganization.

On June 21, 1971 the Pennsylvania reorganization court issued an order directing the Penn Central trustees to appear before the Connecticut reorganization court and to object to the entry of any order based on that court's decision of June 11, on the ground that the Connecticut reorganization court had no jurisdiction to issue an order of the nature indicated by the decision of June 11. The order of the Pennsylvania reorganization court enjoined any person "from taking any action which would enforce, collect or cause to be perfected or paid any claim against the Debtor or its estate arising out of the inclusion of the New

Haven into the Debtor, other than in these proceedings, or which would interfere with the primary jurisdiction of this Court to deal with properties in its possession or under its control pending further order of this court." In contravention of the constructive trust declared, but not yet ordered, by the Connecticut reorganization court, the Pennsylvania court directed the Penn Central trustees to use all the income from the Grand Central Terminal properties to pay Penn Central's current expenses. Despite this action, the Connecticut reorganization court entered its order on June 22 and appointed counsel to perfect the interest of the New Haven estate in the property. An appeal of the order of the Connecticut district court was thereupon taken to this court.

I. The Issues

The issue presented by this appeal is whether the Connecticut district court had jurisdiction to declare an equitable lien on the property transferred by New Haven to Penn Central and a constructive trust on that portion of the income from the Grand Central Terminal properties that, prior to the transfer, New Haven had the right to receive.

Section 77(a) of the Bankruptcy Act, 11 U.S.C. §205(a) (1970), provides in relevant part:

> "If the petition [stating that the railroad is insolvent and wishes to reorganize its capital structure] is so approved [by a judge of the district court of proper venue], the court in which the order is entered shall, during the pendency of the proceedings under the section and for the purposes thereof, have *exclusive jurisdiction of the debtor and its property wherever located.* . . ." (Emphasis added).

In the present case we are faced with conflicting claims of subject matter jurisdiction over certain property by two

district courts sitting as reorganization courts in proceedings involving two debtor railroads. The property over which both courts claim jurisdiction is the property formerly comprising the assets of the New Haven that the New Haven was required to transfer to Penn Central before the receipt of compensation for it. The Connecticut reorganization court approved the transfer of all these properties to Penn Central in return for consideration in an amount and form to be determined in further proceedings.

The appellants argue that the Connecticut reorganization court had no jurisdiction to declare an equitable lien and a constructive trust on property and income formerly belonging to the New Haven. They maintain that, since the property was transferred to Penn Central almost three years before the issuance of the order that is the subject of this appeal, the Pennsylvania district court had exclusive jurisdiction under §77(a) to determine all rights and interests in all of Penn Central's property, including the former property of the New Haven.

The appellees advance four bases of jurisdiction upon which the Connecticut district court could premise its order of June 22. First, they say, the "exclusive jurisdiction" provision of §77(a) cannot be read literally, and the district court's action comports with the policy underlying that section. Second, the Connecticut reorganization court had jurisdiction to implement the Supreme Court's mandate in the *New Haven Inclusion Cases*. Third, the Connecticut reorganization court reserved jurisdiction, in its order authorizing the transfer of the New Haven estate's assets, over the property so transferred. Finally, the Connecticut reorganization court had *in personam* jurisdiction over the Penn Central trustees and thus had the power to adjudicate the rights of the parties in property not located within the court's territorial jurisdiction.

II. Section 77(a) Jurisdiction

The problem here presented concerns the conflict of jurisdiction between two federal courts each claiming jurisdiction to affect interests in certain property over which, under a literal reading of §77(a), one federal court has "exclusive jurisdiction." Although conflicting claims of jurisdiction under §77(a) are not uncommon, the usual type of conflict is between a state court and a federal court, in which the state court's action would in some way interfere with the federal court's administration or actual reorganization of the debtor railroad. See *Gardner* v. *New Jersey*, 329 U.S. 565 (1947); *Thompson* v. *Texas Mexican Ry.*, 328 U.S. 134 (1946); *Board of Dirs. of St. Francis Levee Dist.* v. *Kurn*, 98 F.2d 394 (8th Cir. 1938). Cf. *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939). Situations involving that type of conflict involve factors arising from the federal-state relationship that are not present in the instant case. See *Callaway* v. *Benton*, 336 U.S. 132 (1949); *Meyer* v. *Fleming*, 327 U.S. 161 (1946); *Thompson* v. *Magnolia Petroleum Co.*, 309 U.S. 478 (1940); *In re New York, N.H. & H. R.R.*, 109 F.2d 136 (2d Cir. 1940). Cf. 28 U.S.C. §1334 (1970).

The Congressional purpose behind the enactment of §77 in general and the "exclusive jurisdiction" provision of §77(a) in particular was to eliminate the need for ancillary receivership proceedings in federal courts in every state in which the railroad operated its lines. See Rodgers & Groom, *Reorganization of Railroad Corporations Under Section 77 of the Bankruptcy Act*, 33 Colum.L.Rev. 571 (1933); Craven & Fuller, *The 1935 Amendments of the Railroad Bankruptcy Law*, 49 Harv. L. Rev. 1254 (1936). The overlapping jurisdiction of numerous courts was not conducive to the speedy and efficient reorganization of a financially unsound railroad. See Fuller, *The Background and Techniques of Equity and Bankruptcy Railroad Reorganizations*—A Survey, 7 Law & Contemp Probs 377 (1940);

Laughlin, *The Extraterritorial Powers of Receivers*, 45 Harv. L. Rev. 429 (1932); Morehouse, *Receiverships*, 7 Yale L.J. 299 (1898). By eliminating the need for ancillary receivership proceedings and providing for "exclusive jurisdiction" in one federal court with nationwide service of process, see §77(a); *Continental Ill. Nat'l Bank & Trust Co.* v. *Chicago, R.I. & Pac. Ry.*, 294 U.S. 648 (1935), Congress intended to vest subject matter jurisdiction over the debtor railroad and its property in one federal court which would have adsolute power over that property and over the administration of the roalroad pending the submission of a reorganization plan by the Interstate Commerce Commission and approval of such a plan by the court. See *Ecker* v. *Western Pac. RR.*, 318 U.S. 448, 466-74 (1943). Cf. *Palmer* v. *Massachusetts*, supra at 88-89 and n. 15.

The Supreme Court's decision in *Warren* v. *Palmer*, 310 U.S. 132 (1940) is determinative of this case. The *Palmer* case involved the conflict between two federal district courts sitting as reorganized courts pursuant to §77(a), with each claiming subject matter jurisdiction over the same property. The Boston & Providence Railroad leased one of its lines to the Old Colony Railroad, and Old Colony then leased the line to the New York, New Haven and Hartford Railroad. The New Haven, experiencing financial difficulties, filed a petition for reorganization which was approved by the district court for the District of Connecticut. After various proceedings, the court ordered the New Haven trustees to reject the B & P lease pursuant to §77(c)(6) and to operate the line for the account of B & P. Shortly thereafter the B & P filed a petition for reorganization which was approved by the district court for the District of Massachusetts. As the line operated by the New Haven trustees for the account of B & P was incurring losses, the New Haven trustees requested and the Connecticut district court granted a lien on the B & P property in the

amount of the loss. The Supreme Court upheld the jurisdiction of the Connecticut court to declare a lien which would be binding on the Massachusetts district court. The Supreme Court said:

> "The property of the Boston and Providence came into the *possession* of the trustees of the New Haven and the Old Colony and remained there during the entire time covered by the claim. These roads were lessees of the property and debtors under §77 in the Connecticut court. It is immaterial what title the debtors had, whether a lease or a fee. The physical property covered by the lease was in the custody of the Connecticut court by virtue of the provisions of §77(a) . . . .
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> . . . .
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> . . . In view of the public importance of rail service, we think this subsetion [§77(c)(6)] represents an intention to give the court *charged with operation* the fullest ability to secure the necessities of operation—an intention to give the operating court power to promise those having the materials, men and equipment needed for operation a first lien on the road to secure payment for the operation."

310 U.S. at 138-40 (footnotes omitted; emphasis added). See also *Thompson* v. *Magnolia Petroleum Co.*, supra, at 481-82. The Supreme Court had earlier stated in *Ex parte Baldwin*, 291 U.S. 610, 615-16 (1934):

> "All property in the possession of a bankrupt of which he claims the ownership passes, upon the filing of a petition in bankruptcy, into the custody of the court in bankruptcy . . . . The jurisdiction in such cases is exclusive of the jurisdiction of other courts, although otherwise the controversy would be cognizable in them . . . .

> . . . But the exclusive jurisdiction acquired by the bankruptcy court through taking possession of the interurban railway under claim of title, was not limited to the prevention of interference with the use of the land . . . . The jurisdiction extends also to the adjudication of questions respecting the title."

To accept appellees' argument that the "exclusive jurisdiction" provision of §77(a) in this context does not in fact mean "exclusive"

> "would tend greatly to foment conflicts between coordinate courts and compel creditors, in the protection of their interests, to ride the circuit, demonstrating the basis of their positions in successive courts. Surely such a state of affairs would not constitute the intended improvement over the practice in equity receiverships, wherein the task of ascertaining charges and assessing liens had been consolidated . . . in the court of primary jurisdiction."

In re New York, N.H. & H. R.R., 26 F. Supp. 18, 23 (D. Conn.), aff'd sub nom. *Palmer* v. *Warren*, 108 F.2d 164 (2d Cir. 1939), aff'd, 310 U.S. 132 (1940), quoted with approval in *New Haven Inclusion Cases, supra*, 399 U.S. at 427. See also *New England Coal & Coke Co.* v. *Rutland R.R.*, 143 F.2d 179, 184 (2d Cir. 1944), quoted with approval in *New Haven Inclusion Cases, supra*, 399 U.S. at 426. The position of the commentators is that, in a situation such as this, "exclusive jurisdiction" is given and should be given its literal meaning. See Mussman and Riesenfeld, *Jurisdiction in Bankruptcy*, 13 Law & Contemp. Probs. 88, 97-99 (1948); Rodgers & Groom, supra at 607-08 and n. 207; Weiner, *Reorganization Under Section 77: A Comment*, 33 Colum. L. Rev. 834, 846-48 (1933); 5 Collier, *Bankruptcy* §77.11 (14th Ed. 1970).

We hold, therefore, that because Penn Central had legal title to and actual possession of the former assets of

New Haven when its petition was approved; because Penn Central was, and the trustees are, using those assets and the income therefrom to operate its lines and the former lines of the New Haven; because the order of the Connecticut district court could, at this stage of the Penn Central reorganization proceedings, seriously impair the formulation of a workable plan for the financial resuscitation of Penn Central by the Commission and the ability of the Pennsylvania reorganization court to administer the entire Penn Central system, of which the New Haven line is but a division, see, *e.g.*, §77(o), 11 U.S.C. §205(o) (1970), only the Pennsylvania reorganization court had subject matter jurisdiction under §77(a) over the property here in question.

III. The Supreme Court's Mandate in the *New Haven Inclusion Cases*

Appellees maintain that the Connecticut reorganization court had jurisdiction to declare the equitable lien and constructive trust, in order to provide that the New Haven would receive "reasonable assurance" of full payment for the assets transferred to Penn Central, under the terms of the mandate of the Supreme Court in the *New Haven Inclusion Cases.*

Penn Central's petition for reorganization was appoved eight days before the Supreme Court's decision in *New Haven Inclusion Cases.* The Supreme Court said at the beginning of its opinion:

> "On June 21, 1970, the Penn Central Transportation Company filed a petition for reorganization . . . in the United States District Court for the Eastern District of Pennsylvania. Whether the financial obligations dealt with in the present opinion may become subject to modification in or because of those proceedings is a question with which the present opinion in no way deals."

New Haven Inclusion Cases, supra at 399 n.+. The Court set aside the order of the Connecticut district court and remanded for "[f]urther proceedings before the Commission and the *appropriate federal courts* . . . to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central." Id. at 489 (emphasis added).

In view of the language accompanying the remand, we do not interpret the mandate as conferring jurisdiction on the Connecticut reorganization court, particularly when as we have demonstrated, the interpretations of and policy underlying §77(a) clearly require the opposite result.

IV. Retention of Jurisdiction and *In Personam* Jurisdiction

Appellees would have us hold that the Connecticut district court, in its order transferring the New Haven's assets to Penn Central and ordering inclusion, retained "jurisdiction to act on any question respecting claims between the two railroads." However the order cannot be properly interpreted as either encompassing this type of equitable action or, indeed, any action based on events occurring subsequent to the transfer order. See *Towers Hotel Corp.* v. *Lafayette Nat'l Bank*, 148 F.2d 145 (2d Cir. 1945).

Even assuming that the reservation of jurisdiction could be construed as encompassing the type of action involved here, once the property came within the "exclusive jurisdiction" of the Pennsylvania reorganization court by virtue of that court's approval of Penn Central's petition for reorganization, the policy of §77(a) would prevent acceptance of appellees' contention. Due consideration of the congressional purpose in granting "exclusive jurisdiction" over the debtor's property to the reorganization court,

would preclude permitting another district court to exercise jurisdiction on the ground that such jurisdiction was reserved in a related proceeding when the effect of the exercise of retained jurisdiction would be to hinder the ability of the reorganization court to administer the property of the railroad pending reorganization. Thus, even if the Connecticut reorganization court's order were construed to include the reservation of jurisdiction to declare an equitable lien and a constructive trust, the subsequent approval of Penn Central's petition by the Pennsylvania reorganization court served to oust the Connecticut court's jurisdiction and to vest "exclusive jurisdiction" in the Pennsylvania court.

Appellees' final contention, that the Connecticut reorganization court had jurisdiction to declare the lien and constructive trust because it had *in personam* jurisdiction over the Penn Central trustees, is without merit. Even if the Connecticut court had *in personam* jurisdiction, it lacked subject matter jurisdiction; the Pennsylvania reorganization court had "exclusive jurisdiction" over the subject matter—the former property of New Haven— and only that court was competent to take action with respect to that property.

V. Remand

This case must be remanded to the Commission so that a reorganization plan, fair and equitable to all parties, can be formulated. One of the main reasons for the enactment of §77 was to establish a reorganization procedure in which an expert agency would examine the technical and financial problems of the railroad and propose a reorganization plan to the reorganization court for approval. As both the Penn Central and the New Haven are in reorganization, at least nominally, before courts in different circuits, the Commission is the common denominator between those

courts so far as the formulation of a single plan, or two interrelated plans, is concerned. Whatever protection the New Haven estate must receive in terms of some senior position in the Penn Central proceeding must first be proposed by the Commission in the context of a reorganization plan for the Penn Central which, it is to be hoped, will advance the public interest by successfully establishing a financially viable Penn Central. The Commission has stated that, if the proceeding is remanded to it, it will consolidate the Penn Central reorganization and New Haven inclusion proceedings so as to consider the terms of the New Haven inclusion as "a portion of the reorganization of Penn Central . . ." This procedure is, we believe, the proper method by which the interests of all parties—the New Haven estate, Penn Central and its creditors, and the public—can best be advanced.

We do not imply by this remand that we disagree either with the fairness of Judge Anderson's order or with his conclusion that the Supreme Court's opinion in *New Haven Inclusion Cases* requires that the New Haven estate receive $174.6 million as compensation for the taking of its property. We hold only that the Connecticut reorganization court is not the proper body to grant whatever protection is required because it has no jurisdiction, and we remand the case to the Interstate Commerce Commission with directions to consider, in light of the Penn Central reorganization, the form of consideration the New Haven estate should receive.

Reversed and remanded to the Interstate Commerce Commission.

MANSFIELD, *Circuit Judge* (Concurring and Dissenting):

I concur in the majority opinion to the extent that it remands the case to the Interstate Commerce Commission with directions, in the light of the Penn Central reorganiza-

tion, to consider the form of the consideration which the New Haven estate is to receive. However, I dissent from the view that the Connecticut reorganization court lacks jurisdiction to review the fairness and equity of the consideration to be paid by the Penn Central to the New Haven estate. In my view the unusual factual and legal background of this dispute suggests that the Connecticut and Pennsylvania reorganization courts have concurrent jurisdiction over the subject matter.

I agree with the majority that once the Penn Central Railroad was placed in reorganization pursuant to §77 of the Bankruptcy Act the Pennsylvania court was vested by §77(a) with exclusive jurisdiction over its properties, including those that had been transferred to it by the New Haven pursuant to the Connecticut court's authorization. Thereafter the Connecticut court was barred from taking any action which might have the effect of interfering with the Pennsylvania court's operation of the railroad in reorganization under its jurisdiction. Although the creation of a lien and a constructive trust upon assets of the Penn Central might not have the immediate effect of disrupting that court's operation of the railroad, such action could pose the threat of doing so. For example, if the Pennsylvania court wished to raise money for operation of the railroad by further mortgaging its properties, it might be frustrated unless it had the power to disregard or set aside the lien and trust declared by the Connecticut court.

Although the Connecticut court may not take any action which would have the effect of interfering with the Pennsylvania court's operation of the railroad, I do not agree that the Commission and the Pennsylvania court have the power, unilaterally and without approval of the Connecticut court, to determine the form of the consideration that is to be paid to the New Haven estate and its creditors for the assets transferred to the Penn Central. The Connecticut court continues to function as a §77 reorganization

court and has been vested by the Supreme Court with the powers of a reviewing court under §5 of the Interstate Commerce Act. 399 U.S. at 430. As such it has a vital interest in the final determination of the terms and conditions of the New Haven's inclusion in the Penn Central. Indeed the Supreme Court, after careful review, accepted the Connecticut court's formulation of those terms. It remanded only because the "impact of recent events," which I construe to mean the Penn Central's bankruptcy (expressly referred to by the Court at page 399 n. †), had rendered unrealistic the provisions for the Penn Central's underwriting, at $87.50 per share, of the stock to be transferred by it to the New Haven pursuant to the plan, thereby depriving the New Haven and its creditors of the purchase price to which they were constitutionally entitled.

The reorganization of the New Haven Railroad and its merger into the Penn Central will not have been completed until the fairness and equity of the terms and conditions of the transfer of its assets to the Penn Central, including the form of the consideration that is to be received, have finally been determined. The Connecticut court continues to have the power and the duty as a reviewing court under §5 of the Interstate Commerce Act and as a reorganization court under §77 of the Bankruptcy Act, to participate in that determination. If the New Haven estate had become in effect a mere subsidiary or ward of the Pennsylvania court for reorganization purposes, the Supreme Court, which knew that the Penn Central was in reorganization and which was aware of the provision of §77(a) giving "exclusive jurisdiction" to a reorganization court over properties in its possession, see 399 U.S. at 420, would have held that the form of the consideration to be paid by the Penn Central must thereafter be determined by the Pennsylvania court as part of the reorganization of the Penn Central, and it would have directed that upon remand the Connecticut court must transfer the case to the Commis-

tion, to consider the form of the consideration which the New Haven estate is to receive. However, I dissent from the view that the Connecticut reorganization court lacks jurisdiction to review the fairness and equity of the consideration to be paid by the Penn Central to the New Haven estate. In my view the unusual factual and legal background of this dispute suggests that the Connecticut and Pennsylvania reorganization courts have concurrent jurisdiction over the subject matter.

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Although the Connecticut court may not take any action which would have the effect of interfering with the Pennsylvania court's operation of the railroad, I do not agree that the Commission and the Pennsylvania court have the power, unilaterally and without approval of the Connecticut court, to determine the form of the consideration that is to be paid to the New Haven estate and its creditors for the assets transferred to the Penn Central. The Connecticut court continues to function as a §77 reorganization

court and has been vested by the Supreme Court with the powers of a reviewing court under §5 of the Interstate Commerce Act. 399 U.S. at 430. As such it has a vital interest in the final determination of the terms and conditions of the New Haven's inclusion in the Penn Central. Indeed the Supreme Court, after careful review, accepted the Connecticut court's formulation of those terms. It remanded only because the "impact of recent events," which I construe to mean the Penn Central's bankruptcy (expressly referred to by the Court at page 399 n. †), had rendered unrealistic the provisions for the Penn Central's underwriting, at $87.50 per share, of the stock to be transferred by it to the New Haven pursuant to the plan, thereby depriving the New Haven and its creditors of the purchase price to which they were constitutionally entitled.

The reorganization of the New Haven Railroad and its merger into the Penn Central will not have been completed until the fairness and equity of the terms and conditions of the transfer of its assets to the Penn Central, including the form of the consideration that is to be received, have finally been determined. The Connecticut court continues to have the power and the duty as a reviewing court under §5 of the Interstate Commerce Act and as a reorganization court under §77 of the Bankruptcy Act, to participate in that determination. If the New Haven estate had become in effect a mere subsidiary or ward of the Pennsylvania court for reorganization purposes, the Supreme Court, which knew that the Penn Central was in reorganization and which was aware of the provision of §77(a) giving "exclusive jurisdiction" to a reorganization court over properties in its possession, see 399 U.S. at 420, would have held that the form of the consideration to be paid by the Penn Central must thereafter be determined by the Pennsylvania court as part of the reorganization of the Penn Central, and it would have directed that upon remand the Connecticut court must transfer the case to the Commis-

sion and the Pennsylvania court. Instead it remanded the case to the Connecticut court, stating:

> "Further proceedings before the Commission and the appropriate federal courts will be necessary to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central." 399 U.S. at 489.

The Supreme Court's remand of the case to the Connecticut court without further qualifications, coupled with the use of the plural term "courts," confirms the view that the Connecticut court was not to be stripped of its powers as a reviewing court.

I further disagree with the majority's view that *Warren* v. *Palmer*, 310 U.S 132 (1940), "is determinative of this case" or that it has the effect of precluding the Connecticut court from having a voice in the fairness and equity of the consideration to be received by the New Haven and its creditors from the Penn Central. Although that decision did involve a question of competing jurisdiction between two §77 reorganization courts, it turned on a provision of the Bankruptcy Act not applicable here, §77(c)(6), which specifically requires a reorganization court that has rejected a leased line to operate it if the lessor is incapable of doing so, in which case continued operation is for the account of the lessor. The Supreme Court interpreted that section as giving "the court charged with operation the fullest ability to secure the necessities of operation," 310 U.S. at 140. In short the Supreme Court understandably decided that a reorganization court operating a leased line must have the power to impose a lien for deficits resulting from its being compelled to operate the line for the benefit of the lessor. The decision hardly precludes the existence of concurrent jurisdiction in an appropriate case.

Thus it appears to me that this case, which is *sui generis*, involves dual or concurrent jurisdiction with respect to

the fairness and equity of the consideration to be paid by the Penn Central in reorganization to the New Haven. While the Pennsylvania court has exclusive jurisdiction over the operation of the Penn Central, including the New Haven Division, the fairness of the consideration to be paid to the New Haven, including the form of that consideration and the status of the New Haven as a creditor in the Penn Central reorganization, as initially formulated by the Commission as the common denominator, is subject to approval by both courts.

That there is nothing novel or unusual about the existence of concurrent jurisdiction in railroad reorganization proceedings is demonstrated by the Supreme Court's recognition at an earlier stage in these proceedings that the Connecticut court, as a §77 reorganization court, and the three-judge district court sitting in the Southern District of New York as a reviewing court under §5 of the Interstate Commerce Act, each had jurisdiction to review the fairness and reasonableness of the terms for inclusion of the New Haven in the Penn Central. See 399 U.S. at 419-30. There the Supreme Court concluded, for reasons set forth in detail, that the three-judge court should have deferred to the Connecticut court. Although there is always the danger that exercise of overlapping or concurrent jurisdiction by two courts may lead to conflict or wasteful duplication of effort, this seems to me to be an instance where "two heads are better than one." An important reason for holding that the Connecticut court should not defer here, which the Supreme Court implicitly recognized in the *New Haven Inclusion Cases*, is that over the years of the New Haven's reorganization the Connecticut court has become intimately familiar with the complicated factual and legal issues arising out of the New Haven's reorganization, thereby gaining a manifest expertise in the valuation of its assets. While I have no doubt about the competence of the highly respected Pennsylvania court to review the matter, it seems to me that in a matter of such importance both courts, working co-

operatively and with the aid of the Commisson, can function effectively to produce a result that will assure all parties a greater degree of fairness and equity than might otherwise be realized.

Thus none of the conditions mandating that one court defer to the other seems to exist here. The issue cannot be resolved in favor of the Pennsylvania court on the ground that it first acquired jurisdiction through possession of the New Haven properties (the basis used by the Supreme Court in the *New Haven Inclusion Cases*). The Connecticut court was the first to acquire possession as a reorganization court and it continued thereafter in possession for years, participating in the formulation of the inclusion terms that were approved by the Supreme Court. Nor can it be said that the Connecticut court, by transferring the New Haven properties to the Penn Central, implicitly agreed to defer to the Pennsylvania court. On the contrary, the Connecticut court, in ordering the transfer of the New Haven property to the Penn Central, expressly reserved jurisdiction to pass upon the fairness and adequacy of the consideration and the other terms of inclusion of the New Haven in the Penn Central. Unlike the circumstances surrounding the concurrent jurisdiction of the Connecticut court and the three-judge district court in the Southern District of New York, nothing in the background of the present jurisdictional overlap suggests that either forum here is better equipped for the task than the other. Nor is there any reason to believe that both courts would not cooperate in their review of the terms formulated by the Commission, eventually reaching an agreement. If they should disagree, however, I have no doubt that upon ultimate review of the Penn Central reorganization plan, including the form of consideration to be paid to the New Haven estate, the Supreme Court would appreciate having the recorded views of the Connecticut court, which has become a respected veteran in this protracted and complicated matter.

In the Matter of the NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, Debtor.
No. 30226.

UNITED STATES DISTRICT COURT,
D. CONNECTICUT.
JUNE 11, 1971.

MEMORANDUM OF DECISION ON ISSUE OF EQUITABLE LIEN AND OTHER MATTERS PRELIMINARY TO REMAND TO INTERSTATE COMMERCE COMMISSION

ANDERSON, Circuit Judge.*

This is an unusual case, and the features which make it so stem from the basic circumstances that the New Haven Railroad, a deficit operation for several years prior to and throughout the seven years of operation in reorganization, was kept going in the public interest; that it was compelled, again in the public interest, to transfer its properties and assets to Penn Central Transportation Company (Penn Central),[1] receiving in return, at the time, only a small

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* Sitting by designation.

[1] As used in this opinion the term "Penn Central" means the Penn Central Transportation Company, a railroad, which since June 21, 1970, has been in railroad reorganization in the United States District Court for the Eastern District of Pennsylvania.

Prior to October 1, 1969, the corporate name of the Debtor was Penn Central Company. The term "Penn Central Company" presently refers to a Pennsylvania corporation which holds all of the stock of the operating railroad which is the Penn Central Transportation Company. While the New Haven Trustee originally received stock of the railroad Penn Central Company at the time of the New Haven's inclusion on December 31, 1968, the stock which he presently holds is stock of the parent Penn Central Company that he received in exchange for the stock of the present Debtor, the Penn Central Transportation Company, pursuant to its plan of corporate reorganization which was approved by its stockholders and made effective on October 1, 1969.

fraction of the true and actual value of the New Haven's properties and assets while it awaited a value determination by the Supreme Court; and that the Penn Central itself went into bankruptcy shortly before the Supreme Court's decision. Although the case is unique, the controlling principles are those of simple justice.

Penn Central filed its petition for reorganization in the Eastern District of Pennsylvania on June 21, 1970. Eight days later, on June 29, 1970 the Supreme Court decided the New Haven Inclusion Cases, 399 U.S. 392, 90 S.Ct. 2054, 26 L.Ed.2d 691. On July 31, 1970 the Supreme Court's judgment was filed in the New Haven reorganization court, which, on August 10, 1970, directed the Trustee of the New Haven and any other parties desiring to be heard to file written statements of position, particularly as to six designated subjects hereinafter referred to as paragraphs A, B, C, D, E and F,[2] to be considered by the court in connection with the form of order to be issued in carrying out the terms of the Supreme Court decision.

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[2] Those six subjects are:

A. Whether and, if so, to what extent, this court should modify its prior orders with respect to Step II of the plan of reorganization for the New Haven heretofore approved by the Interstate Commerce Commission and this court, as a result of said opinion of the Supreme Court.

B. Whether this court should indicate to the Interstate Commerce Commission specific views or recommendations with respect to the proceedings to be conducted by the Interstate Commerce Commission in its further proceedings in the premises, and, if so, what such views or recommendations should be.

C. Whether this court may order an equitable lien on or otherwise subject the assets conveyed to the present Penn Central Transportation Company on December 31, 1968 by the then Trustees of the New Haven to a first security interest in favor of the New Haven and, if so, whether such an order should be entered and what its terms should be in conformity with said opinion of the Supreme Court.

D. Whether this court may order the trustee of the indenture securing the Divisional First Mortgage Bonds issued by the present

Statements of position and briefs were filed by the principal parties and the case is ready for remand by this court to the Interstate Commerce Commission (I.C.C.). Meanwhile many constructive steps have been taken and much has been accomplished in resolving the problems implicit in these subjects through negotiation by representatives of the Penn Central and New Haven estates, and through action taken by the Penn Central reorganization court, over which Judge John P. Fullam presides. Similarly in the case of the Boston and Providence Railroad Corporation (B & P), there were the additional collaboration of the representatives of the B & P estate and the necessary action by the B & P reorganization court, over which Judge Francis J. W. Ford presides. Thus as to ¶ F, the B & P

Penn Central Transportation Company to the then Trustees of New Haven, in part consideration for the assets of the New Haven conveyed on December 31, 1968, or order the Trustees of Penn Central Transportation Company, to pay over or cause to be paid over to the Trustee of the New Haven all proceeds from the sale of mortgaged property now on deposit with such indenture trustee, all future proceeds remaining to be paid with respect to sales of mortgaged property heretofore made, and all proceeds of mortgaged property hereafter sold, leased or otherwise divested by the Trustees of Penn Central Transportation Company and, if so, whether such an order should be entered and what its terms should be in conformity with said opinion of the Supreme Court.

E. Whether this court may order the Trustees of Penn Central Transportation Company to pay over to the Trustee of the New Haven, periodically as may be determined pending resolution by the Interstate Commerce Commission and judicial review of the issues remanded by the Supreme Court, of an amount equal to half the excess income from the Grand Central Terminal properties and, if so, whether such an order should be entered and what its terms should be in conformity with said opinion of the Supreme Court.

F. Whether this court may order the Trustees of Penn Central Transportation Company and the Trustee of the New Haven to carry out as soon as possible the plan of reorganization of the Boston and Providence Railroad Corporation and, if so, whether such an order should be entered and what its terms should be in conformity with said opinion of the Supreme Court.

reorganization has been fully consummated, and a railroad reorganization instituted in 1938 has thereby been concluded.

As to ¶ D, again through negotiation and this time with the approval of the Penn Central reorganization court and this court, the Penn Central Trustees and the New Haven Trustee divided equally some $18 million received from the sale of assets which the New Haven had conveyed to Penn Central on December 31, 1968. While the subject of future drawdowns by the New Haven estate of the proceeds from sales and leases of former New Haven property warrants continued consideration, the matters within ¶ D may at this time be dismissed without prejudice. The subjects of paragraphs A, B, C and E remain for consideration.

JURISDICTION

At the threshold, the Trustees of the Penn Central challenge the jurisdiction of this court to make a declaration as to the foregoing subjects and the issues they involve. This court, however, has long had jurisdiction over the person of Penn Central, both under its present and former name, as a party to this action. See 399 U.S. at 428, n. 57, 90 S.Ct. 2054. At the time of the conveyance of New Haven's assets to Penn Central on December 31, 1968 the court expressly reserved jurisdiction over subject matters relating to the payment of the price, including the form of payment. The Penn Central has appeared and actively participated in all of the proceedings before this court concerning the transfer of assets and payment for them from December 19, 1968 forward, including the period from the time when Penn Central petitioned in reorganization to the present.

This court has the exclusive jurisdiction to determine the effect of the Supreme Court's mandate in the *New Haven Inclusion Cases*, and this court must decide what is to be done to implement it. The full price required

to be paid for the New Haven's assets was decided, but the terms of the payment were not; and this court alone must review and determine what means, pursuant to the Supreme Court's mandate, are proper. The I.C.C. cannot adjudicate the issues of law now before this court, for these lie outside its jurisdiction. The Commission itself has so held in principle in the Boston & Providence Railroad Reorganization Proceedings, 290 I.C.C. 363, 382 (1954), 327 I.C.C. 10, 15 (1966), and, again, in the very proceeding before this court the Commission stated:

> "It is not within our jurisdiction to fix New Haven's legal rights, if any, in the Grand Central Terminal properties." Pennsylvania Railroad Company — Merger — New York Central Railroad Company, 331 I.C.C. 643, 680 (1967).

This court, with the aid of a special master appointed by it, adjudged those rights.

So here, the Commission has no jurisdiction to decide the legal questions of the New Haven's status, whether as that of a stockholder or creditor, including the type of creditor, and the further related question as to whether or not the New Haven estate has a full security interest in its former properties for the balance of the purchase price. These are legal questions which are for this court's determination in construing the Supreme Court's mandate. In the circumstances of this case ordinary sense and logic call for a resolution of these paramount issues before remand of the case to the I.C.C. in order that it may proceed with prior knowledge of how the legal questions have been adjudicated.

The Penn Central Trustees point to §77(a) where it says the reorganization court "* * * shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor

and its property wherever located * * *," and argue that all jurisdiction is in the Penn Central reorganization court and only that court can impose or declare a lien or determine any other questions affecting the New Haven properties transferred to Penn Central on December 31, 1968. Of course, the language of §77(a) literally gives the New Haven reorganization court exclusive jurisdiction over all legal or equitable interests which the New Haven has in any property, even though it may be in the possession of the Penn Central. The Penn Central's Trustees' argument ignores the fact that the New Haven reorganization court not only reserved jurisdiction over the matter of payment for the assets transferred to Penn Central by the inclusion order itself, but it has a mandate from the Supreme Court to deal further with questions relating to the determination of the rights and obligations of the parties with regard to the form of payment for the property of the New Haven transferred to the Penn Central. It would be odd, indeed, if by the same decision, this court were barred, for example, from determining whether or not in the circumstances an equitable lien should be declared which would relate back to December 31, 1968, the date of the transfer, because meanwhile the transferee, over whom this court has long had jurisdiction with respect to the terms of the transfer, filed for §77 reorganization itself in the Eastern District of Pennsylvania. It should clearly be borne in mind, however, that this court claims only the power to declare the existence of an equitable lien on the conveyed property, including a constructive trust to the extent of the capitalized value of one-half of the excess income from the Grand Central properties, for the balance due on the purchase price. With the property in the possession of the Trustees of the Penn Central and with the duties of operation resting on that company's Trustees, the New Haven reorganization court does not under present circumstances assert the power to enforce such a lien. The declaration of a lien

will have no adverse impact on the ability of the Penn Central to operate as a railroad, and the Penn Central reorganization court will remain wholly in control of the effect, if any, of such a lien on the operations of the railroad and on its reorganization plan formulation.

The fact that the adjudication which the court is now making does not interfere with Penn Central operations or plan formulation distinguishes this case from Gardner v. New Jersey, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947), where New Jersey was attempting to pull out chunks of the railroad from the reorganization court's jurisdiction; and from Warren v. Palmer, 310 U.S. 132, 60 S.Ct. 865, 84 L.Ed. 1118 (1940), where the Supreme Court relied on § 77(c) (6) and the principle against interference with operations to sustain the jurisdiction of the New Haven reorganization court. *Warren* v. *Palmer* clearly illustrates that the "exclusive jurisdiction" clause cannot literally be relied on. In that case the B & P was under the "exclusive jurisdiction" of the reorganization court in Boston. The New Haven and the Old Colony Railroads were under the "exclusive jurisdiction" of the United States District Court at New Haven. The Old Colony Trustees and the New Haven Trustees rejected the B & P lease; the New Haven was ordered to operate the formerly leased lines for the account of the B & P; and the question was whether the New Haven reorganization court could adjudge a lien for operations on the B & P property. Here there were two reorganization courts, each with "exclusive jurisdiction" over the debtor and its property wherever located. Reading § 77(a) literally, the B & P reorganization court in Boston, with "exclusive jurisdiction" over the B & P, had exclusive jurisdiction over the B & P lines because the lease had been rejected and the B & P was owner. Yet the Supreme Court sustained the "exclusive jurisdiction" of the New Haven reorganization court to declare a lien on the B & P property. The Supreme

Court sustained that exercise of power by reference to § 77(c) (6), which deals with the rejection of leases and operations of leased lines, and emphasized that the jurisdiction of the New Haven reorganization court was being sustained because the matter dealt with operations.

The B & P affords another illustration of how the statutory provision for "exclusive jurisdiction" accommodates to practical situations. As pointed out *supra*, three reorganization courts, each with "exclusive jurisdiction" adjudged matters within its peculiar jurisdiction to effect the consummation of the B & P reorganization.

The "exclusive jurisdiction" clause in § 77(a) was designed to eliminate the need for ancillary receivership proceedings; to give one court, the reorganization court, power to preserve the railroad as a unit and as a going concern, and, with the aid of the I.C.C., to approve a plan of reorganization. Accordingly, suits may be brought against the reorganization trustees on claims arising out of rail operations in any court of competent jurisdiction; and, even though the reorganization court has summary jurisdiction, it must, in an appropriate situation, permit an adjudication of the matter to be made in another court. Thompson v. Magnolia Petroleum Company, 309 U.S. 478, 60 S.Ct. 628, 84 L.Ed. 876 (1940).

That the "exclusive jurisdiction" clause must always be read in light of its background is further made evident in relation to accounts receivable held by a railroad in reorganization. Penn Central, for example, has millions of dollars of accounts receivable. A purely literal reading of the "exclusive jurisdiction" clause would suggest that such collection proceedings would have to be conducted before the reorganization court. However, it is elementary that the Penn Central reorganization court does not have jurisdiction, over the objection of an account debtor, of proceedings

to collect these accounts receivable. In re Standard Gas & Electric Co., (Hastings v. H. M. Byllesby & Co.) 119 F.2d 658 (3 Cir. 1941); 2 Collier on Bankruptcy (14th ed.) ¶ 23.05 [4]. Plenary suits for this purpose must be brought in courts of competent jurisdiction and would not come before the reorganization court.

That language in this area of bankruptcy cannot be applied with orthological exactitude is further demonstrated by 28 U.S.C. § 1334. This section provides:

> "The district courts shall have original jurisdiction, exclusive of the courts of the States, of all matters and proceedings in bankruptcy."

Yet it is accepted practice that hundreds of actions involving bankruptcy matters can and are brought in the state courts. 1 Moore's Federal Practice (2d ed.) ¶ 0.–60 [8.–6]. Indeed, at times, they must be brought in a state court. Thompson v. Magnolia Petroleum Company, *supra*.

This Court's jurisdiction is supported by other principles, such as the line of cases holding that a court which has *in personam* jurisdiction can nevertheless determine rights with respect to property in the *in rem* jurisdiction of another court, Barrett v. International Underwriters, Inc., 346 F.2d 345 (7 Cir. 1965); Dempsey v. Pink, 92 F.2d 572 (2 Cir. 1937), cert. denied 303 U.S. 648, 58 S.Ct. 745, 82 L.Ed. 1109 (1938); 1A Moore's Federal Practice (2d ed.) ¶ 0.222; and also by cases which, while recognizing that state courts have exclusive jurisdiction over probate matters, hold that the federal courts nevertheless have jurisdiction over *inter partes* suits, otherwise within federal jurisdiction, that do not usurp jurisdiction of a probate nature. 1 Moore's Federal Practice (2d ed.) ¶ 0.60 [1], p. 604.

Moreover, there are compelling practical reasons why this court should resolve the issues now before it. In addi-

tion to the Supreme Court's mandate, this court has had the advantage of a decade of dealing with the complex factual circumstances which have attended the New Haven's reorganization, with the clashing claims made by multiple contending parties and the continuing duty to protect the New Haven estate. It is the only district court that has had to hear and rule upon every aspect of the case from its beginning to the inception of the present issues. For reasons analogous to those which prompted the Supreme Court to recognize this reorganization court as having preferred jurisdiction over the three-judge court in New York to determine the price to be paid for the property transferred to Penn Central, this court has like jurisdiction to hear and decide the issues now before it.

Outline of Events Leading to Inclusion Cases in Supreme Court and Construction of Mandate.

A brief résumé of the pertinent events leading up to the Supreme Court's hearing of the *New Haven Inclusion Cases* is essential to an understanding of the rationale of its decision and to a sense of what is called for in implementing it.

After the New Haven had been in reorganization and had carried on its deficit operation for seven years during which its assets had been depleted by 60 to 70 million dollars in the public interest, this court decided that it could not allow the interests of the New Haven bondholders to be further eroded after the end of 1968 because the constitutional prohibition against the taking of private property without just compensation forbade it. At the same time the court continued to be acutely aware of the crucial importance of the railroad to the economy of southern New England and the public interest in preserving its operation. Accordingly, because the Pennsylvania and New York Central

Railroads had voluntarily agreed — in a contract that became irrevocable upon their merger on February 1, 1968 — to include the New Haven as a condition of their merger, the Interstate Commerce Commission and this court ordered the merged Penn Central physically to take over the properties and operations of the New Haven by the end of 1968. The inclusion took place on December 31, 1968. At the time of the transfer the Penn Central paid, exclusive of the 956,576 shares of Penn Central stock, about $63 million on account of the indebtedness ultimately found due by the Supreme Court and which, as a part of its own merger, Penn Central had agreed to pay. Penn Central and all other parties knew on December 31, 1968 that the total value of the consideration Penn Central was to pay remained for future determination by the federal courts.

Two federal district courts had been concurrently exercising jurisdiction and were principally concerned with the issue of fair and equitable price which Penn Central should pay for the assets of the New Haven. A three-judge district court for the Southern District of New York, exercising jurisdiction under § 5 of the Interstate Commerce Act, had on July 10, 1968 enjoined the order of the I.C.C. originally fixing the price to be paid by Penn Central for the New Haven's assets at $125,000,000. This reorganization court, exercising jurisdiction under § 77 of the Bankruptcy Act, on August 13, 1968 similarly rejected that price.[3] Subsequently, the I.C.C. in its Fourth Supplemental Report fixed the purchase cost to Penn Central at $140,600,000, plus $5 million for a share of the New Haven's operation losses in 1968, for an aggregate total of $145,600,00. In reviewing this valuation, this reorganization court held that the I.C.C. legally erred as to six items for an undervaluation of $29,-

[3] As the Supreme Court noted in the New Haven Inclusion Cases, the three-judge court estimated the $125 million figure was an understatement on the order of $45 million to $50 million, and the reorganization court, $33 million to $55 million. 399 U.S. at 414-415, 90 S.Ct. 2054.

035,899.[4] Accordingly, it fixed the total cost to Penn Central at $174,635,899. The three-judge district court, on the other hand, found an undervaluation of only $990,000. Penn Central acquiesced in this finding and paid this additional amount to New Haven.[5] The price differential between this reorganization court and the three-judge district court was in the neighborhood of $28 million.

The other side of the problem was whether the consideration which Penn Central had paid New Haven was equal to the credit given Penn Central. The real controversy swirled around the value attributable to the 956,576 shares of common stock of the Penn Central Company. This reorganization court, mindful of its duty to see that all are treated fairly, on its own initiative, formulated underwriting provisions designed to assure that the New Haven would obtain a per share value of $87.50; and, as underwritten, approved the per share value of $87.50. The three-judge court adopted the same underwriting provisions and the $87.50 figure.

As the cases reached the Supreme Court, Penn Central had been credited in round figures as follows: $33.3 million

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[4] The reorganization court held that the Commission had legally erred as to the following items (the first five increased the price, the sixth reduced it):

$15,386,000	one year abandonment delay
6,695,000	bulk sale discount
4,439,000	Bronx Yards
1,600,000	improper deduction for tax obligations
2,415,899	excess discount to present value
— 1,500,000	CCBI's
$29,035,899	

[5] It did this on November 11, 1969. The "mix" of the consideration paid was:

$370,260	bonds
565,290	stock
54,450	cash
$990,000	

for assumption of certain obligations of New Haven, cancellation of certificates issued by the Trustees of the New Haven, and cash payments; approximately $29.6 million for the $34,025,800 principal amount of 5% Divisional First Mortgage bonds of Penn Central that liened the former New Haven rail properties; and $83.7 million, the value assigned to the common stock.

The Supreme Court (1) held that although the three-judge court initially had jurisdiction concerning the merger, it should have stayed its hand in determining the price to be paid by Penn Central and the value of the consideration Penn Central had transferred to the New Haven, since this reorganization court was the preferred court to determine those matters; (2) affirmed this court in all respects as to price; and (3) stated that at the time of this court's decision, it had correctly decided as to the value of the common stock, in the light of this court's proposed underwriting, but that because of recent events, i. e. Penn Central's bankruptcy, "The reorganization court's decree may be wholly unrealistic," as indeed is now is, and that "a reassessment of the consideration that Penn Central is to give in exchange for" the New Haven's assets is required.

The Supreme Court's decision clearly requires a realistic assessment—not a formal one, for if only the latter had been in the Court's mind, the Court would have affirmed in toto. Nothing would have remained to be done except to determine how the additional price should be paid.

It was clearly the intent of this court, the parties, and the Commission that the New Haven estate would be fully compensated. The Constitution requires as much. This court formulated the underwriting provisions for the stock with the belief that these would make the New Haven whole as to the value attributed to the stock, but Penn Central's

bankruptcy has made all the provisions concerning the stock "wholly unrealistic."[6]

"The fairness and equity that are the essence of a §77 proceeding," the Supreme Court stated, "forbid our approval of a payment for the transferred New Haven properties that may be worth only a fraction of its purported value." 399 U.S. at 488, 90 S.Ct. at 2108.

Continuing, the Court said:

> "* * * In the circumstances of this case, and for the reasons we have already set out at length, we agree with the reorganization court that it would be unfair and inequitable to allow Penn Central to take the properties for any lesser sum [liquidation value]. Moreover, we today require a reassessment of the consideration that Penn Central is to give in exchange for those properties. We thereby accord the bondholders the right to a liquidation and a per-parcel sale that is theirs by virtue of their mortgage liens. * *" 399 U.S. at 489-490, 90 S.Ct. at 2108.
>
> And "* * * we must also reject any lingering suggestion by Penn Central that the price it must pay for the New Haven assets is unfair in either a statutory or a constitutional sense. * *" 399 U.S. at 493, 90 S.Ct. at 2110.

Accordingly, the Supreme Court's mandate obligates the Trustees of Penn Central to see that the New Haven estate is fully compensated for the remaining balance due the New Haven in the amount of $132 million plus, with interest.

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[6] Cautiously, the Supreme Court said: "may be wholly unrealistic." 399 U.S. at 488, 90 S.Ct. 2054.

While such cautionary language was proper at a time only 8 days after Penn Central's bankruptcy, the intervening year strips away the "may be" qualification and makes clear that the stock arrangement is "wholly unrealistic."

The Supreme Court, at 489, 90 S.Ct. at 2108, stated that

> "* * * further proceedings before the Commission and the appropriate federal courts will be necessary to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central."

It also, at page 399, 90 S.Ct. at page 2061, noted the petition of the Penn Central for reorganization under § 77 and stated:

> "Whether the financial obligations dealt with in the present opinion may become subject to modification in or because of those proceedings is a question with which the present opinion in no way deals."

It is this court's position that the nature and form (including whether or not it should be treated as secured) of the indebtedness of Penn Central to the New Haven for the assets transferred, long before Penn Central went into reorganization, and at a time when both the New Haven, as debtor, and Penn Central were solely under the jurisdiction of this court, are matters within the exclusive jurisdiction of this court. Both the New Haven and Penn Central reorganization courts have the duty and jurisdiction to protect the New Haven's constitutional right not to have the equity imposed security of the transferred properties further confiscated in the public interest. The Penn Central reorganization court has exclusive jurisdiction over any action by the New Haven Trustee to enforce his equitable lien and also over the form of the consideration and its time and manner of payment as they may be affected by a fair and equitable plan of reorganization of the Penn Central.

This position is consonent with the Supreme Court's statements above quoted.

Implementation of the Supreme Court's Mandate.

(Including discussion of ¶ C, note 2, supra)

In order fully to compensate the New Haven estate for the balance remaining due and to provide reasonable security for the sum owed, it is the opinion of this court that the Supreme Court's mandate must be implemented by providing: (1) that the 956,576 shares of common stock of the Penn Central Company, the parent Company, should be treated as collateral security, of indeterminate value, for the balance of the purchase price due by the Penn Central Trustees; it is wholly unrealistic to treat the stock otherwise; (2) that an equitable lien must be declared on all of the former assets transferred by the New Haven to Penn Central, exclusive of (a) rolling stock and (b) the New Haven's one-half interest in the excess income from the Grand Central properties; and (3) that the Penn Central Trustees hold the latter item of property subject to a constructive trust in favor of the New Haven estate.

The above mentionad equitable lien is not a consensual lien nor is it an involuntary equitable lien arising out of a judicial proceeding, such as that which emanates from a creditor's bill to reach and apply equitable assets which are beyond the grasp of legal process. See Freedman's Savings & Trust Co. v. Earle, 110 U.S. 710, 4 S.Ct. 226, 28 L.Ed. 301 (1884). The lien here invoked is the kind which the chancellor creates to do equity under the peculiar circumstances of the case, and, in particular, by the bankruptcy chancellor to implement a just reorganization under § 77 of the Bankruptcy Act.

The Trustee's brief sets forth a reasonably good description of this type of equitable lien as follows:

"An equitable lien has been defined as a right, not existing at law, to have specific property applied in whole or in part to the payment of a particular debt. Thus, there must be a debt or obligation and a *res* to which the debt can attach. The doctrine is a remedy for a debt, based upon traditional equitable theories of estoppel and unjust enrichment. An equitable lien may be imposed where one party, by a course of conduct, has raised the expectation in the other party that an obligation will be secured, or where one party takes a conveyance or assignment of the property of another and retains the property without paying for it. Morrison Flying Service v. Deming National Bank, 404, F.2d 856 (10th Cir. 1968), cert. den. 393 U.S. 1020 [89 S.Ct. 628, 21 L.Ed.2d 565] (1969); Reconstruction Finance Corp. v. Sun Lumber Company, 126 F.2d 731 (4th Cir. 1942); Westall v. Wood, 212 Mass. 540 [99 N.E. 325] (1912)."

The Tenth Circuit also stated the matter well:

"An equitable lien is a creature of equity, is based on the equitable doctrine of unjust enrichment, and is the right to have a fund or specific property applied to the payment of a particular debt. Such a lien may be declared by a court of equity out of general considerations of right and justice as applied to the relationship of the parties." (Footnotes omitted.) Caldwell v. Armstrong, 342 F.2d 485, 490 (10 Cir. 1965).

In the first place it was expected and intended by the parties that full payment would be made to the New Haven Trustees for the property, assets and rights which they conveyed to the Penn Central. The I.C.C. ordered Penn Central to pay a price less than the fair liquidation value of the property; and it was not until June 29, 1970 that the full purchase price was determined by the Supreme Court's decision. Meanwhile the Penn Central Transportation Com-

pany went into reorganization. Its Trustees now assert that the New Haven Trustee has at best no more than a general claim in bankruptcy for the balance of the purchase price. This ignores the whole history of the New Haven inclusion, the general terms and framework of which stem from the contract of April 21, 1966, made between the New Haven Trustees and the Pennsylvania and New York Central Railroads. 399 U.S. 409–413, 90 S.Ct. 2054. This contemplated a simultaneous payment of the purchase price at the time of the transfer of the New Haven's assets to the merged Penn Central. As the Supreme Court said, 399 U.S. at 410, n. 45, 90 S.Ct. at 2067:

> "The transfer was to be free and clear of all liens and encumbrances, with minor exceptions. The liens and encumbrances would shift to the proceeds of the sale and thus remain an obligation of the New Haven estate."

This concept followed through, to and including the actual transfer. Except for some high priority claims, the real parties to whom the proceeds of the sale and transfer belong are the New Haven bondholders. They had secured claims before the transfer of the assets to the Penn Central on December 31, 1968 and the parties had agreed and intended that the New Haven bondholders would have a secured claim after the transfer of assets by having a lien on the proceeds. The reason the New Haven bondholders do not in law have such security is because the Penn Central Transportation Company has not paid the full proceeds to which the bondholders' lien can shift and attach. In equity, therefore, their lien on the property, which was the subject of the transfer, did not "shift to the proceeds of the sale" but remains on the property transferred.

The Penn Central Trustees argue that any such claim is foreclosed by the order and deed of transfer which said the property was conveyed "free and clear of all liens,

charges and encumbrances thereon." This covenant, customarily incorporated in the overwhelming majority of transfers in the ownership of the fee of real property and frequently incorporated in instruments of conveyance at bankruptcy sales, may render a transfer free of such liens as a consensual lien or a judicial lien arising out of a creditor's bill, but it does not constitute a waiver of the chancellor's equitable lien or a bar to his power to create one. If this customary clause were to constitute a waiver of the chancellor's equitable lien, the bankruptcy chancellor would be shorn of his power to protect the estate in any situation where the covenant or clause "free and clear" was used and there could be no such thing as an equitable lien in that sense. The clause cannot be used either in law or equity to insulate a grantee who has failed to pay the purchase price from having the property subject to an equitable lien in favor of the grantor. The parties were fully cognizant of the fact that the total purchase price had not been determined, that it would not be fixed for several months, but that whatever the Supreme Court said it was, the Penn Central had a duty to pay it. By the time the price had been determined Penn Central had maneuvered itself into a financial debacle and had filed a petition for reorganization under § 77.

The fact that the New Haven was compelled in the public interest to convey its properties to the Penn Central without simultaneously receiving the full purchase price did not constitute a waiver of a lien which at that time could not be determined. A party can only waive a known right and it must do so intentionally. Neither fact existed here. The right to additional payment of purchase price on which a matured lien would depend was not then adjudicated. The New Haven had, at the time of the transfer, an inchoate lien with which the property was impressed. It could only become a matured lien through the act or default of the grantee, itself, the Penn Central. This is accomplished by

failure to pay the price fixed by the Supreme Court. In the circumstances of the case, this is not the kind of lien referred to by the "free and clear of all liens * *" clause in the deed of conveyance which was intended only to cover liens and encumbrances imposed by act of the grantor or third persons and not those caused by the act of the grantee itself. The matured equitable lien relates back to the date of the transfer, which was the date the inchoate lien arose which the act of the Penn Central itself brought to fruition.

Its Trustees take the position that the New Haven Trustee and the New Haven bondholders, as beneficial owners, have no equitable claim at all; that the New Haven Trustees made an agreement of sale, got a down payment, including shares in Penn Central, which they said they wanted, and conveyed the property of the New Haven to the Penn Central. Though there is still due and unpaid on the purchase price agreed to be paid over $132,000,000, the Penn Central Trustes say the New Haven is only a common creditor, at best, except for the divisional mortgage. They argue that no security for this purchase price should be afforded the New Haven estate because the old New Haven assets might have to be expended in the public interest to pay for the Penn Central's operational losses and further, if anything were left, the New Haven property should be used to secure the Penn Central's other creditors, presumably its other bondholders. For example, Manufacturers Hanover Trust Co., Indenture Trustee under N. Y. Central & Hudson River R. R. Co. Gold Bond Mortgage of 1897, claims that the New Haven property comes within the provisions of its mortgage. The Penn Central Trustees do not contradict this.

Thus one sees the New Haven's properties and assets, which on December 31, 1968 furnished some security for the New Haven bondholders, who had contributed substantially to their acquisition, transferred to Penn Central,

which, after paying only a small fraction of the price in actual money's worth before going into reorganization, now through its Trustees contemplates using the property to make up for its own operational losses or to furnish additional security for its bondholders and other creditors. Certainly these are circumstances that cry out for equitable relief.

The Penn Central Trustees are actually seeking an unjust enrichment. These putative beneficiaries never gave any consideration for the acquisition of these properties by the New Haven and they have no equity in them which is the equivalent of or superior to that of the New Haven bondholders.

Considerable emphasis must be given to the fact that the issue of an equitable lien in favor of the New Haven estate on the property transferred to Penn Central on December 31, 1968, affects *only* the interests of the two parties, i.e. the New Haven and the Penn Central. Interests of third parties, innocent or otherwise, are not involved, because no creditor entered into a credit transaction with the Trustees of Penn Central in reliance upon Penn Central's ownership of the New Haven property unencumbered by an equitable lien.[7] While the State of Connecticut appears to make such a claim, its interest is in seeing that no equitable lien will impair the agreement between the Connecticut Transportation Authority and Penn Central Transportation Company, and it is abundantly clear that the equitable lien claimed by the New Haven would not do so. As a result of the negotiated settlement between the Trustee of the New Haven and the Trustees of the Penn Central, relating to the Penn Central's acquisition of the B & P and reflected in the

[7] The declaration of an equitable lien in the present case is not intended to affect, nor should it be construed to affect, former properties of the New Haven transferred to Penn Central and which were conveyed as non-operating properties by Penn Central to third persons between January 1, 1969 and the date of the filing of this memorandum of decision.

petition for and in this court's order Number 634, dated February 16, 1971, the declaration by this court of an equitable lien on former properties of the New Haven will not apply to the former properties of the B & P. See also Order Number 636, dated March 22, 1971.

Although the Penn Central's Trustees strongly imply the contrary, the deficit ridden New Haven Railroad was not foisted upon Penn Central; rather the Pennsylvania and N. Y. Central Railroads voluntarily agreed to purchase and operate it as a condition to their right to merge. They knew the New Haven was a deficit operation and had been for over a decade. They knew the New Haven would continue to be so, at least for some years to come. The suggestion that Penn Central's own financial difficulty was brought on "to some extent" by losses of the New Haven, coupled with the intimation that this creates a kind of equitable claim by Penn Central which off-sets a claim by the New Haven is untenable.

The condition of the New Haven Railroad was known to the world. It appears that the true condition of the Penn Central may not have been. If either party was misled to its damage in the inclusion transaction, it was not the Penn Central. It seems likely at present that the true financial condition and position of the Penn Central at the time of its acceptance of the transfer of the New Haven's properties, was not, and had not been fully disclosed to the Interstate Commerce Commission, the federal courts or the Trustees of the New Haven or its bondholders.

The Trustees of the Penn Central concede in their brief that if there had been fraud involved on the part of Penn Central in taking over the New Haven properties, there would be ground for the imposition of an equitable lien. Fraud was not alleged in the statements of position now before this court, and is not being considered as a part of the record of the case. The court, however, is aware of Con-

gressional and I.C.C. reports and other materials which suggest that an inquiry may be needed to determine whether or not the officers and directors of Penn Central on December 31, 1968 knew, in the exercise of their duties, or reasonably ought to have known, of facts concerning their company's financial condition which were of vital concern to the New Haven's Trustees and creditors but not disclosed to them. The purpose of mentioning this is to make clear that in ruling on the present issues, this court is in no wise [sic] adjudicating any question of fraud or reckless mismanagement which is the functional equivalent of fraud. It expressly reserves jurisdiction to hear and decide such questions as may arise out of any non-disclosure of material information relating to the transfer of the New Haven's properties to Penn Central, and the promise by the latter to pay for them the price which the Supreme Court determined to be fair and equitable insofar as such questions concern the interests of the bankrupt New Haven Railroad.

It must be remembered that the early time of the transfer of properties and assets of the New Haven on December 31, 1968 in advance of a final judicial determination of the actual price to be paid and on payment by the Penn Central of only a small fraction of what that price was ultimately held to be, was not sought by any of the parties. Rather it was imposed by ruling of the I.C.C. and the order of this court. At that time it was opposed by Penn Central in an effort to compel the approval, in substance, of the I.C.C.'s findings and conclusions relative to price as a condition precedent to its taking over the New Haven; and the New Haven First Mortgage Bondholders were calling for liquidation. The Trustes of the New Haven simply followed the directions of this court. The transfer was not effected in the interest of or for the benefit of the New Haven's creditors. It was done simply and solely in the public interest to keep the trains of the New Haven running. The New Haven Railroad faced a grave emergency. It had suffered

and was continuing to suffer staggering losses so that its operations could not be continued beyond 1968. The price issue could not possibly, short of stipulation, be finally adjudicated until after 1968, and immediate inclusion in spite of no final price determination was the only solution.

There remain for discussion the assertions by the Penn Central Trustees and the I.C.C. that the public interest requires that the New Haven properties conveyed to Penn Central be held free of any lien and available to be encumbered by, or expended for losses incurred in the deficit operation of keeping the Penn Central trains going in the public interest.

The Penn Central Trustees argue as follows:

> "The equities favoring the Penn Central's unencumbered ownership of the former New Haven assets, on the other hand, are overwhelming. First, as the Commission and courts have recognized, 'the first policy to be served in reorganization proceedings is "continued operation of the property * *."' Fourth Supplemental Report and Order, 334 I.C.C. 25, 61 (1968). Transfer of the New Haven Assets was designed to further this interest:
>
> > 'A total abandonment of the NH would be inconsistent with the public interest * * * Operation by Penn Central, on the other hand, provides a feasible and achievable alternative. Yet, in order for Penn-Central to effectively rescue the NH operations, it must be free to conduct them according to the dictates of good and efficient management as an integrated part of its own system. *This it cannot do if it must take the NH properties without the power of disposition over them and subject to the creditors' liens.*' 344 I.C.C. at 75 (Emphasis added.)

> The central reason for ordering inclusion of the New Haven assets on December 31, 1968, 'free and clear of all liens and encumbrances,' was to facilitate the maintenance of the railroad as an operating entity in the public interest."

In the *New Haven Inclusion Cases*, however, the Supreme Court said:

> "After 35 years of § 77, as amended, it is unnecessary to reanvass the two basic objectives of the statute—the conservation of the debtor's assets for the benefit of creditors and the preservation of an on-going railroad in the public interest." 399 U.S. at 431, 90 S.Ct. at 2078.

It is quite clear that a bankrupt railroad's estate (which is to say the owners of rail securities) must sustain the burden of losses incurred in a deficit operation for a reasonable period following the petition in bankruptcy and before abandonment to enable governmental officials and those who represent the public to take steps to preserve railroad transportation service if they are satisfied it is in the public interest to do so. In the *New Haven Inclusion Cases*, 399 U.S. at 491, 90 S.Ct. at 2109, the court said:

> "The rights of the bondholders are not absolute. As we have had occasion to say before, security holders
>
> > 'cannot be called upon to sacrifice their property so that a depression-proof railroad system might be created. But they invested their capital in a public utility that does owe an obligation to the public. * * * [B]y their entry into a railroad enterprise, [they] assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs.' Reconstruction Finance Corp. v. Denver & R. G. W. R. Co., 328 U.S. 495, 535–536, 66 S.Ct. 1282, 90 L.Ed. 1400."

But the public interest cannot demand the erosion of the bankrupt's assets to the point of confiscating practically the entire estate. At some point the extent and degree of taking runs into the constitutional prohibition in the Fifth Amendment the taking of private property for public use without just compensation. The time needed to afford the public a fair opportunity to take the necessary action to provide for the continuance of rail service rests in the sound discretion of the reorganization court. The estate of the New Haven Railroad lost between 60 and 70 million dollars in maintaining its deficit operation up to January 1, 1969. This court held that any further erosion of the estate of the New Haven in the public interest would be an unconstitutional taking of private property without just compensation and this was affirmed by the Supreme Court. 399 U.S. at 466, 90 S.Ct. 2054.

The Commission, however, had taken a view which appeared to arrogate to itself almost absolute authority over the extent to which a debtor railroad's estate could be consumed in compelling it to continue a deficit of operation.

In its Fourth Supplemental Report, 344 I.C.C. 25 at 55-56, the I.C.C. in discussing Railroad Commission of Texas v. Eastern Texas RR., 264 U.S. 79, 44 S.Ct. 247, 68 L.Ed. 569 (1924), held that " * * * if at any time it develops with reasonable certainty that future operation must be at a loss, the company may discontinue operation and get what it can out of the property by dismantling the road. To compel it to go on at a loss or to give up the salvage value would be to take its property without just compensation which is a part of due process of law."

The Commission went on to mention that the *Eastern Texas* case cited Brooks-Scanlon Co. v. Railroad Commission of Louisiana, 251 U.S. 396, 40 S.Ct. 183, 64 L.Ed. 323 (1920), which had held that a railroad may abandon even a branch line that loses money and cited in support of this,

Munn v. Illinois, 94 U.S. 113, 126, 24 L.Ed. 77 (1876). It then stated that the *Munn* and *Scanlon* cases had been overruled *sub silentio* by Colorado v. United States, 271 U.S. 153, 166, 168, 46 S.Ct. 452, 70 L.Ed. 878 (1926), which preserved "the Commission's role in weighing the advantages and disadvantages of abandonment of branch lines." Through further discussion in the report and in its briefs and oral arguments the Commission seemed to have adopted a general doctrine that it had the power to compell the continued deficit operations, *regardless of devastating losses*, provided, it could find it was in the public interest to do so. Pursuant to this theory it decided that, despite the New Haven estate's losses of 60 to 70 million by December 31, 1968, it could withhold the right to abandon for another year and thereby saddle the New Haven with at least another $15 million in losses. The Supreme Court rejected the Commission's claims. 399 U.S. 457–467, 90 S.Ct. 2054. In spite of this the Commission now objects to the imposition of an equitable lien on the former New Haven properties to secure the payment for those very some [sic] properties, on the ground that it might interfere with the further consumption of those assets if it became necessary to dispose of them in the course of continuing Penn Central's deficit operation in the public interest.

In oral argument on its statement of position concerning the declaration of an equitable lien the Commission said:

> "* * * the committee in its reply brief would apparently read that lien to mean that New Haven would be entitled to satisfaction of New Haven's claims against Penn Central in the form of a receipt of the proceeds from the sale of the former New Haven assets and Mr. Auerbach has essentially repeated that message this morning.
>
> But those proceeds may indeed be needed for operations of Penn Central." Tr. pp. 58–59.

And this in spite of the fact that in its Fourth Supplemental Report, 344 I.C.C. 75, the Commission said:

> "The NH creditors *are guaranteed* just and reasonable compensation and other terms for their interests in the NH, whenever distribution of the compensation shall occur, whether at the time of or after the properties pass to Penn Central. Since Penn Central must include the NH and must pay a price just and reasonable to all concerned, the creditors lose nothing, vis-a-vis Penn Central, by having *their liens* transferred from the NH properties to the consideration which Penn Central will eventually have to pay." (Emphasis supplied.)

But guaranteed by what?

By mid-night December 31, 1968 the public interest had extracted the last penny which it could constitutionally take from the property and assets of the bankrupt New Haven estate. The Supreme Court had so decided. It said, 399 U.S. at 466, 90 S.Ct. at 2096:

> "We think the reorganization court was entirely correct in concluding that:
>
> > 'The policy of imposing an interim burden of losses, through its deficit operation, on a railroad in reorganization is to afford a reasonable opportunity to the responsible agencies to arrange the continuation of the railroad's operation, but the law does not require the furnishing of two or three or four opportunities. The duty was more than amply fulfilled by the New Haven. The public interest has had one huge bite of the apple; it is not entitled to another.' 304 F.Supp. 793, at 801."

It also approved this court's finding "'* * * * that the continued erosion of the Debtor's estate from operational losses

after the end of 1968 will clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation. It is therefore constitutionaliy impermissible, and obviously no reorganization plan which calls for such a taking can be approved.' 289 F.Supp. 451, at 459.'' 399 U.S. at 491, 90 S.Ct. at 2109.

The constitutionally forbidden erosion which could not be imposed directly cannot now be accomplished indirectly by preventing and withholding the declaration of an equitable lien. Such a lien is required to protect the already adjudicated constitutional rights of the New Haven estate. It must be reiterated that the conveyance of the transportation plant of the New Haven Railroad to the Penn Central in advance of the determination of the price to be paid for it, was made solely for and on behalf of the public interest, but there is a constitutional bar which prevents the public interest from extracting anything further out of the assets of the New Haven. The only other party affected is the Penn Central, and certainly it has no right in law or equity to take the valuable properties and assets of the New Haven estate for a small fraction of their fair value.

There are sufficient bases discussed earlier in this opinion to warrant the declaration of an equitable lien on the transferred property in favor of the New Haven estate. But even if those grounds did not exist, the present circumstances in which the Penn Central seeks to prevent the granting of any security for the $132,000,000, rightfully owed, and from the beginning agreed by the contracting parties to be a *liened* claim in favor of the New Haven bondholders and also seeks to appropriate and use the properties to cover its own deficit operations or to secure its own creditors, reenforced by the position of the I.C.C. that the former New Haven properties and assets must be left unencumbered so that they may be available for further erosion by supporting a continuing deficit operation in the public in-

terest, all point to the absolute necessity for imposing an equitable lien on the properties and assets to protect and preserve the rights and interest declared by the Supreme Court to belong to the New Haven estate and to prevent their being dissipated away by persons who are not entitled to them.

As stated at the outset, the facts and circumstances of this case are entirely unique. The reports show no case even roughly comparable. Equity did not cease to function on the date of the last decision which imposed an equitable lien on property. If ever an equitable remedy was called for, it is here in this case. It is the only means by which the rights of the New Haven creditors can be protected. The Penn Central asserts that only two of the four States, in which the New Haven Railroad ran, recognize the doctrine of equitable lien. But that is not so. The doctrine is recognized in all four of the States,[5] and when remedial justice requires, the equity court will impose an equitable lien on personal property as well as on real estate, Porter v. Searle, 228 F.2d 748 (10 Cir. 1955); Caldwell v. Armstrong, *supra*, and it is the opinion of this court that the courts of

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[5] New York and Rhode Island have long recognized the doctrine of equitable liens. Birnbaum v. Rollerama, Inc., 232 N.Y.S. 2d 188 (Sup.Ct. 1962); Zeiser v. Cohn, 207 N.Y. 407, 101 N.E. 184 (1913); Passarelli v. Passarelli, 94 R.I. 157, 179 A.2d 330 (1962). While Massachusetts did not recognize the doctrine prior to 1912, Ahrend v. Odiorne, 118 Mass. 261 (1875), it has given effect to equitable liens since that date. Beacon Trust Company v. Dolan, 27 F.2d 247 (1 Cir. 1928); Westall v. Wood, 212 Mass. 540, 99 N.E. 325 (1912). In Connecticut, the courts have indicated a readiness to apply equitable liens in an appropriate case. Gruss v. Miskinis, 130 Conn. 367, 34 A.2d 600 (1943); see also Hall v. Hall, 50 Conn. 104 (1882); Chapman v. Beardsley, 31 Conn. 115 (1862).

If the lien law to be applied here were limited to that of only one of the four states, presumably it would be that of New York. See Section 29 of the Agreement, dated April 21, 1966, between The Pennsylvania Railroad Company, The New York Central Railroad Company, and the Trustees of the New Haven. And New York law unequivocally supports the equitable lien as a "recognized agency of remedial justice." Zeiser v. Cohn, supra.

last resort of all of the States, if they had this case before them, would hold it to be one in which the doctrine of equitable lien could be considered and applied.

But irrespective of state law the federal interest in bankruptcy and reorganization is paramount, and where circumstances warrant, as in the case at bar, a federal court would be justified in declaring an equitable lien to accomplish a just reorganization. See Hurley v. Atchison, T. & S. F. Railway Co., 213 U.S. 126, S.Ct. 466, 53 L.Ed. 729 (1909). This is consistent with many rulings where the bankruptcy court, applying equitable principles, did not feel constrained by state law. Thus while state laws normally determine property rights and interests, they will not be allowed to subvert the general policies of the Bankruptcy Act, and a bankruptcy court may, when necessary, determine property interests, irrespective of state law, to implement those policies.[9] For example, equitable principles governing bankruptcy distribution require the bankruptcy court to allow a claim of interest on interest. Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946). And the principles of equitable subordination are not controlled by state law. Prudence Realization Corp. v. Geist, 316 U.S. 89, 62 S.Ct. 978, 86 L.Ed. 1293 (1942); Pepper v. Litton, 308 U.S. 295, 60 S. Ct. 238, 84 L.Ed. 281 (1939); Taylor v. Standard Gas & Electric Co., 306 U.S. 307, 59 S.Ct. 543, 83 L.Ed. 669 (1939). In Prudence Realization Corp. v. Geist the Court said, 316 U.S. at 95, 62 S.Ct. at 982:

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[9] Board of Trade of City of Chicago v. Johnson, 264 U.S. 1, 44 S.Ct. 232, 68 L.Ed. 533 (1924), held that a bankrupt's seat on the Board of Trade constituted a property interest under the Bankruptcy Act which passed to the trustee, although under state law there was no property interest reachable by creditors; Lines v. Frederick, 400 U.S. 18, 91 S.Ct. 113, 27 L.Ed.2d 124 (1970), held that accrued vacation pay of a bankrupt wage earner was not property which passed to his trustee because of the policy of the Bankruptcy Act in relation to wage earners.

"Nothing decided in Erie R. Co. v. Tompkins [304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188] requires a court of bankruptcy to apply * * * a local rule governing the liquidation of insolvent estates. * * * The court of bankruptcy is a court of equity * * and it is for that court — not without appropriate regard for rights acquired under rules of state law — to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class."

Constructive Trust on Grand Central Terminal Properties

(Including discussion of ¶ E, note 2, supra)

All of the reasons supporting an equitable lien, discussed above, support an adjudication that the property interest in the Grand Central Terminal properties, which the New Haven transferred to Penn Central, is subject to a construction trust in the New Haven's favor.

Originally, this reorganization court, with the aid of a special master, undertook its own resolution of the legal question as to whether the New Haven had a property interest in the terminal properties that would survive a cessation of rail operations by the New Haven, and the court concluded that the New Haven did have such an interest which should be measured by the capitalization of one-half of the excess income remaining after satisfaction of the terminal expenses. Thereafter the Commission fixed this value at $28,438,000 and both this court and the Supreme Court approved.

This court now concludes that a constructive trust in the foregoing amount should attach to all of the terminal properties as of December 31, 1968; and, additionally, as to the

actual monies received by Penn Central, on or after July 1, 1971, from those properties, one-half of the excess income is impressed with a trust in favor of the New Haven estate.

Subjecting the properties to a constructive trust as of December 31, 1968 is fair to both the New Haven and Penn Central. It protects the New Haven estate's interest from being subjected to mortgage and other creditor interests of Penn Central whose equities are junior to those of the New Haven. Since the properties involved are non-operating properties, the revesting in the New Haven of its transferred title and rights does not affect Penn Central's rail operations, and the revesting protects the New Haven against conveyances of and encumbrances upon those interests without the New Haven being paid the value of its interest, which, incidentally, is roughly equivalent to the overall increase in price which this court adjudged and the Supreme Court affirmed. After stating that "fairness and equity" forbid approval of only a fractional payment of New Haven's value, the Supreme Court added: "And the same considerations of fairness and equity prevent imposing on Penn Central the burden of immediate payment in full * * *," 399 U.S. at 488, 90 S.Ct. at 2108.

In testing the order for a declaration of a constructive trust by these criteria the court has given weight to these considerations: (a) if sales or other similar dispositions of Grand Central properties are made, an appropriate liquidation of the New Haven's interest under the constructive trust is not burdensome upon Penn Central; (b) immediate payment will be required only out of income currently realized from non-rail operations, which will be relatively small in amount when compared to the total amount due by Penn Central, i.e., $132 million; (c) the date of July 1, 1971 comes a year after Penn Central went into bankruptcy and after the Supreme Court enunciated this balance of fairness approach; and (d) the payment is necessary to preserve the

New Haven reorganization. The New Haven's assets consist of approximately $14 million in cash or cash equivalents, and its claim against Penn Central. Following cessation of dividend and interest payments by Penn Central, the income of the New Haven estate became essentially limited to the earnings of the cash equivalents — treasury bills, certificates of deposit, and the like. On the other hand, the estate has approximately $52 million of administrative claims which include $7 million or more of tort claims, mostly FELA cases, $12.5 million due the United States on defaulted trustees' certificates, and $17 million of real estate taxes in addition to pre-bankruptcy liened real estate taxes. Shortly after Penn Central's bankruptcy, necessity required this court, on July 6, 1970, to order the general suspension of payment of claims, although the needs of many creditors — both taxing authorities and injured persons — were great, and the appeals of the seriously injured employees and passengers on humane grounds have been very compelling. Recently, because of these considerations, the court has modified its suspension order to permit the resumption of small quarterly payments on the liquidated tort claims. Funds must be husbanded to keep the Trustee's small staff intact, and to press and safeguard the New Haven's one main asset — the amount justly due to it by the Penn Central. After balancing the equities, this court believes that equity and good conscience require that beginning on July 1, 1971, one-half of the excess income from the Grand Central properties be impressed with a constructive trust. This does not prejudice Penn Central, for it is not entitled to operate on other people's money. Moreover, the Penn Central reorganization court has declared that the Penn Central is not insolvent.

Interest

So that the New Haven estate is fully compensated for the balance of over $132 million due it, the estate is entitled to interest from December 31, 1968 at the ap-

propriate legal rate, with appropriate credits given Penn Central for dividends and interest paid by it and for any payments made on principal, such as the one-half of the proceeds from the sales of former New Haven real estate in the approximate amount of $9 million.

REMAND

(including discussion of ¶ A and ¶ B, note 2, supra.)

The New Haven's plan of reorganization should be remanded to the Interstate Commerce Commission subject to the legal rulings made in this opinion and also to certain legal rulings in this court's Memorandum of Decision on Distributive or Step II Portion of Fourth Supplemental Report and Order of Interstate Commerce Commission rendered on July 28, 1969, 304 F.Supp. 1121. Among other things these concern the accrual of interest and penalties on tax claims, the need to satisfy counsel fees and trustees' certificates in cash, and the provision that any claim covered by the Plan could be settled and paid in cash, subject to the approval of the reorganization court, up to the time of the consummation of the Plan. These legal rulings should stand.

Plan formulation for the New Haven is for the I.C.C. and this court. Similarly, plan formulation of Penn Central is, of course, for the I.C.C. and the Penn Central reorganization court. This court trusts that if it is at all feasible, a plan for the reorganization of the New Haven will be formulated without awaiting the reorganization of Penn Central. The two estates, however, are so intertwined that this may not be practical.

This court recapitulates its principal rulings as follows: that it has plenary jurisdiction to construe and implement the mandate of the Supreme Court; that this obligates the Penn Central Trustees to see that the New Haven estate is fully compensated for the remaining balance of $132 million;

and that under the unusual circumstances of this case this court should and does declare an equitable lien in favor of the New Haven on the tangible property, exclusive of rolling stock, conveyed by it to Penn Central and also declares a constructive trust, in the New Haven's favor, to the extent of the capitalized value of one-half of the excess income received from the Grand Central properties. It remands the plan of reorganization to the Interstate Commerce Commission to carry out and implement this court's adjudication.

SETTLE ORDER on or before 10:30 a.m., June 22, 1971.

In Proceedings for the Reorganization of a Railroad.

In the Matter of The NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, Debtor.
No. 30226.

UNITED STATES DISTRICT COURT,
D. CONNECTICUT.
JUNE 22, 1971.

ORDER OF REMAND ON JUDGMENT OF SUPREME COURT IN THE NEW HAVEN INCLUSION CASES

ANDERSON, Circuit Judge.*

The Interstate Commerce Commission (the "Commission") having certified to this court on December 2, 1968, a plan of reorganization (the "Plan") for the Debtor, as set forth in the Commission's Fourth Supplemental Report on Reconsideration and Further Hearing, dated November 25, 1968 (334 I.C.C. 25), providing for the Debtor's reorganization in two distinct steps, the first of which being a conveyance of the Debtor's assets and operations to Penn Central Company (now Penn Central Transportation Company) ("Penn Central") by January 1, 1969, and Step II of which being the terms of treatment of persons having an equity in the Debtor's estate in the light of the consideration to be received upon such conveyance; and

Objections to the Plan and claims for equitable treatment thereunder having been filed with this court pursuant to its order dated December 3, 1968, and this court having heard on December 20, 1968, the positions of all interested persons with regard to prompt inclusion of the Debtor's operations in the Penn Central system, and having entered its Order No. 559 on December 24, 1968 directing the Trustees of the property of the Debtor to convey the Debtor's

* Sitting by designation.

assets to Penn Central and effect the inclusion of the Debtor's operations in the Penn Central system effective at 11:59 p.m. on December 31, 1968, and having directed Penn Central to carry out such inclusion and to pay the consideration, including the assumption of certain obligations and cancellation of certain indebtedness specified in the Plan, while expressly providing that the same would be without prejudice to the right of any party to contest the fairness and adequacy of the consideration and reserving jurisdiction to adjudicate all of the objections and claims for equitable treatment theretofore filed; and

The conveyance and inclusion having been effected in accordance with Order No. 559, and this court having, in accordance with its reservation of jurisdiction and following receipt of briefs and a hearing, entered an order on July 28, 1969 adjudging the price to be paid by Penn Central for the assets conveyed to it on December 31, 1968, and approving and disapproving certain provisions of Step II of the Plan, and remanding the Plan to the Commission; and appeals and cross appeals from said Order having been taken to the Court of Appeals, which consolidated the same into one case dealing with the issue of consideration and a second dealing with the provisions of Step II; and

The Supreme Court having granted certiorari in the case dealing with the issue of consideration prior to judgment in the Court of Appeals, and having decided the case on June 29, 1970 (New Haven Inclusion Cases, 399 U.S. 382, 90 S.Ct. 2054, 26 L.Ed.2d 691) and its judgment having been filed with this court on July 31, 1970; and

The Court of Appeals, on motion of the parties, having remanded to this court the consolidated cases before it dealing with the provisions of Step II of the Plan; and

On August 10, 1970, this court having directed the Trustee of the Debtor's property and any other parties desiring to be heard to file written statements of position,

particularly with respect to six designated subjects, to be considered by this court in connection with the form of order to be issued in carrying out the terms of the decision of the Supreme Court; and statements of position and briefs having been filed by various persons, including the Trustee of the Debtor's property, the Commission, the United States, and the Trustees in reorganization of the property of Penn Central, pursuant to said order, and this court having heard all persons desiring to be heard; and

On June 11, 1971, this court having filed its Memorandum of Decision on Issue of Equitable Lien and Other Matters Preliminary to Remand to Interstate Commerce Commission and ordered that a decree in accordance therewith be settled on June 22, 1971, and having heard all parties in interest desiring to be heard;

It is ordered that:

1. The value of the Debtor's assets conveyed to Penn Central on December 31, 1968, and the amount required to be paid therefor, is $174,635,899, against which Penn Central is entitled to the following credits:

$14,000,000	cancellation of indebtedness represented by $14,000,000 principal amount of trustees' certificates issued to Penn Central by Trustees of the Debtor's property
133,333	cancellation of accrued interest on above-described trustees' certificates
2,958,667	cash payment made on December 31, 1968
4,908,000	assumption of Debtor's obligations to former employees for vacation pay
2,400,000	assumption of Debtor's obligation under bonds issued in connection with reorganization of Boston and Providence Railroad Corporation
8,416,730	assumption of Debtor's obligations under its Harlem River Division Bonds (based upon Commission's Fourth and Fifth Supplemental Reports)
54,450	cash payment made on November 11, 1969
9,068,661	cash payment made on January 28, 1971
$41,939,841	

The Debtor's estate is entitled to be fully compensated for the balance of $132,696,058, subject to adjustments hereinafter provided.

2. The remainder of the purchase price in the amount of $132,696,058 computed pursuant to paragraph 1, shall be increased by interest on the amounts from time to time unpaid from December 31, 1968 at the legal rate of interest in effect from time to time in the State of New York, as applicable upon the unpaid balance of the purchase price fixed in paragraph 1, until date of payment; and shall be reduced by all interest and dividends received by the Trustee of the property of the Debtor on the 956,576 shares of common stock of Penn Central Company and the $34,025,800 principal amount of Divisional First Mortgage Bonds of Penn Central held by him, together with interest thereon similarly computed.

3. The Trustee of the property of the Debtor shall hold the above-described common stock and bonds of Penn Central as security for the obligations of Penn Central fixed in paragraphs 1 and 2, and to the extent such security is liquidated or is retained under a plan of reorganization Penn Central shall be credited with the fair value thereof.

4. All the tangible property conveyed by the Debtor to Penn Central on December 31, 1968, except rolling stock and the portions of other tangible property as have heretofore been sold by Penn Central or the Trustees in reorganization of its property, is hereby declared subject to an equitable lien as of December 31, 1968 to secure the claims of the Debtor against Penn Central as set forth in paragraphs 1 and 2. So far as the so-called Harlem River Division is concerned, the equitable lien shall be junior to the lien of the mortgage securing the Harlem River Division Bonds.

5. All the right, title and interest of the Debtor in and to the "Grand Central Terminal Property" as set forth in

the assignment dated December 31, 1968 from the Trustees of the property of the Debtor to Penn Central shall be held in trust by Penn Central, or the Trustees in reorganization of its property, for the benefit of the Debtor until the Debtor's estate shall have received $28,438,000, plus interest, from the Grand Central Terminal Property, or the obligations of Penn Central as set forth in paragraphs 1 and 2 have been discharged in full.

6. One-half the excess income from the Grand Central Terminal Property, as determined pursuant to the Supreme Court's decision in the New Haven Inclusion Cases, *supra*, pp. 438–451, 90 S.Ct. 2054, 26 L.Ed.2d 691, shall, commencing July 1, 1971, accrue to the account of the Trustee for the New Haven estate.

7. The Plan is remanded to the Commission for further proceedings in accordance with the decision of the Supreme Court in the New Haven Inclusion Cases, *supra*, this Order, and this court's Order Approving and Disapproving Certain Step II Provisions of the Plan, dated July 28, 1969.

8. The present Order is to be carried out by the Commission in accordance with the Memorandum of Decision of this Court dated June 11, 1971.